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# CORPORATE MERGERS AND ACQUISITIONS IN GENERAL

KF190

## HEARING

BEFORE THE

## COMMITTEE ON THE JUDICIARY UNITED STATES SENATE

NINETY-NINTH CONGRESS

FIRST SESSION

ON

**S. 473**

A BILL TO AMEND THE CLAYTON ACT TO TEMPORARILY PROHIBIT HOSTILE CORPORATE TAKEOVERS OF DOMESTIC PETROLEUM CORPORATIONS

MAY 1, 1985

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# CORPORATE MERGERS AND ACQUISITIONS IN GENERAL—S. 473

WEDNESDAY, MAY 1, 1985

U.S. SENATE,
COMMITTEE ON THE JUDICIARY,
*Washington, DC.*

The committee met, pursuant to notice, at 9:05 a.m., in room SD-226, Dirksen Senate Office Building, Hon. Strom Thurmond (chairman of the committee) presiding.

Also present: Senators Biden, Simon, Specter, Metzenbaum, Denton, McConnell, Grassley, and Hatch.

Staff present: Kenneth Starling, Laurie Westley, Neal Manne, Steve Ross, Nick Chumbris, Victor Maddox, Terry Campo, Stephen Markman, and Cynthia Lebow.

## OPENING STATEMENT OF CHAIRMAN STROM THURMOND

The CHAIRMAN. The committee will come to order. I am a little bit hoarse, but I hope you can hear me.

We are meeting today to hear testimony on a subject of very wide interest in Congress and in corporations throughout the Nation—the subject of corporate takeovers. In recent weeks, the newspapers have been reporting on a substantial number of ongoing tender offers, some of which are regarded as hostile because they are opposed and resisted by the target corporations. Some of these corporate takeover attempts involve billions of dollars and affect hundreds of thousands of shareholders and employees.

The particular concern of this committee is with the antitrust implications of this merger activity. We have before us one piece of legislation, S. 473, introduced by Senators Nickles and Boren. That bill would establish a temporary moratorium on hostile takeovers of domestic petroleum companies.

Our interest in this subject, however, extends beyond that bill because we are interested in the enforcement of the laws against anticompetitive mergers in any line of business.

In this hearing, we will examine the degree to which corporate takeovers may reduce competition. We will also explore the extent to which these contests for corporate control may produce positive effects on competition and benefits to shareholders.

Finally, we will discuss the ways in which potential benefits of such takeover activity are factored into the antitrust analysis of mergers and acquisitions.

Before I call the first witness I wish to place a copy of S. 473 in the record.

[Text of S. 473 follows:]



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II

99TH CONGRESS
1ST SESSION

# S. 473

To amend the Clayton Act to temporarily prohibit hostile corporate takeovers of domestic petroleum corporations.

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IN THE SENATE OF THE UNITED STATES

FEBRUARY 19 (legislative day, FEBRUARY 18), 1985

Mr. NICKLES (for himself and Mr. BOREN) introduced the following bill; which was read twice and referred to the Committee on the Judiciary

---

# A BILL

To amend the Clayton Act to temporarily prohibit hostile corporate takeovers of domestic petroleum corporations.

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,*

TEMPORARY MORATORIUM ON HOSTILE CORPORATE TAKEOVERS

SECTION 1. That section 7 of the Clayton Act (15 U.S.C. 18) is amended by inserting after the second paragraph the following new paragraph:

"During the period beginning February 6, 1985, and ending 6 months after the date of the enactment of this paragraph, no person engaged in commerce or in any activity

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affecting commerce may obtain control of a domestic petroleum corporation if the corporation disapproves the acquisition of control. For purposes of this paragraph—

"(1) the term 'domestic petroleum corporation' means a corporation whose average net production of crude oil in the calendar year preceding the period during which this paragraph is in effect exceeded 20,000 barrels of oil per day or the natural gas or natural gas liquids equivalent;

"(2) the term 'control' means the acquisition of more than 4 percent of the stock, share capital, or assets of a corporation;

"(3) the term 'disapproves' means the disapproval of a majority (consisting of at least two members) of the independent members of the board of directors of the domestic petroleum corporation; and

"(4) the term 'independent' when applied to a member of a board of directors of a domestic petroleum corporation means that the member is not an officer or employee of the corporation and has no substantial financial or commercial ties to the corporation other than the ownership of the corporation's stock.".

INVESTIGATION

SEC. 2. During the period during which the moratorium is in effect under the amendment made by section 1—



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(1) the Secretary of Energy shall investigate the effects of corporate takeovers, which are subject to the moratorium, on the exploration, development, production, refining, transportation, distribution, and marketing of domestic petroleum supplies;

(2) the Federal Trade Commission shall investigate the effects of corporate takeovers, which are subject to the moratorium, on competition in the marketing of petroleum products and other products produced by domestic petroleum corporations and on independent refiners, marketers, and retailers;

(3) the Securities and Exchange Commission shall investigate the effects on the petroleum industry of the financing methods, including the use of high-risk securities, used in corporate takeovers which are subject to the moratorium; and

(4) the Federal Reserve Board, in the exercise of its authority under Regulation U under the Securities Exchange Act of 1934, shall investigate the effect on credit markets of corporate takeovers which are subject to the moratorium.

Upon the completion of the investigations, the Secretary, the Commissions, and the Board shall each report the results of the investigations to the Congress together with such recom-



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1 mendations for legislation as the Secretary, the Commissions,
2 and the Board determine to be appropriate.

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The CHAIRMAN. We have an exceptional group of witnesses today, including the chief antitrust enforcement authorities, businessmen who have had extensive experience in large corporate takeovers, and respected professors of business and economics. We thank you for taking time from your busy schedules to join us today and we look forward with great interest to your testimony.

Now, our first witness today was Senator Nickles. Is he here?

[No response.]

The CHAIRMAN. I do not believe he is here and we are on such a time schedule, I think we will have to go ahead. If he comes in, we will try to take him next.

Senator Simon.

## OPENING STATEMENT OF SENATOR PAUL SIMON

Senator SIMON. Yes, just a brief opening statement. I think, Mr. Chairman, you used the phrase that is an important one, and that is anticompetitive mergers. I used to be in business. I am a believer in the free enterprise system, but we had a situation where 20 years ago, 400 corporations controlled two-thirds of the corporate wealth of this country. We are down now to less than 200 in that situation.

I believe we ought to give every possible tax advantage to corporations that are doing research that are adding to the productivity of this country. But when you find it more profitable to explore for oil on the floor of the New York Stock Exchange rather than the fields of Illinois or South Carolina, then something is wrong.

If I can just use one illustration that involves a corporation that has a major investment in Illinois, U.S. Steel bought Marathon Oil. We have in this country only really two modern steel plants, and I am willing to give breaks to any steel company that modernizes its plant.

But when U.S. Steel spends $6.5 billion to buy Marathon Oil, it does not add one job to this country, does not improve the productivity of our country, does not dig one oil well. It just does nothing for our country.

I am not blaming U.S. Steel. Something is wrong with our tax laws that encourages that kind of acquisition and it soaks up the credit market. Here, we are trying to reduce the deficit and struggling to do it these days, Mr. Chairman, but U.S. Steel borrowed $5.9 billion for this particular acquisition.

I am not picking on U.S. Steel because I could take any number of examples. I think we have something fundamentally wrong here and I do not think this Senate and this Congress should duck this question. So I am looking forward to hearing what the witnesses have to say, Mr. Chairman.

The CHAIRMAN. Has Senator Nickles come in yet?

[No response.]

The CHAIRMAN. We will have to go ahead, then. Our first witness after Senator Nickles is Mr. T. Boone Pickens, Chairman of Mesa Petroleum Co., of Amarillo, TX. Mr. Pickens, if you will come around and have a seat.

Mr. Pickens, we are glad to have you with us and if you have an opening statement, feel free to proceed with that.

STATEMENT OF T. BOONE PICKENS, JR., PRESIDENT AND CHAIRMAN OF THE BOARD, MESA PETROLEUM CO., AMARILLO, TX

Mr. PICKENS. I do have an opening statement and it will be brief, Mr. Chairman. I am Boone Pickens, president of Mesa Petroleum, and I appreciate the opportunity to appear before you today.

I request that the full text of my remarks be submitted for the record.

The CHAIRMAN. Without objection, your full text will be placed in the record and you may proceed.

Mr. PICKENS. Mr. Simon, I have got to speak to a couple of your points there about the steel industry, which has taken about $6 billion in losses. I feel like if the steel industry had restructured like the oil and gas industry is doing today that we probably would not see the steel industry in the United States in the same pitiful situation that it is. So I think that what is going on in the oil and gas industry is very healthy for the industry, for the consumer and for the American people.

One other point: I think you said that there were no wells drilled in Illinois because of the Marathon deal, or South Carolina or fields in those States. I do not believe there is any production or active exploration going on in South Carolina, but Illinois is certainly a mature area that has peaked many years ago and is in a steady decline on their production, as is Texas, Oklahoma, Louisiana, and other States in the United States.

So we do have an industry that is having severe problems, and it is not because we have a lack of capital in the industry. It is because we have a lack of good places to drill is what has happened to us.

We peaked on rig count in December 1981 at 4,531 rigs. Today, this week, we have 1,860 rigs operating in the United States. The reason we do not have more rigs drilling in the United States is not because of a lack of capital to explore here in the lower 48 States. It is because we do not have enough prospects to drill.

I might give you one statistic which is rather interesting. Of all the wells that have been drilled in the world today since the first well was drilled, 80 percent of them have been drilled in the lower 48. Therein, we are a high-cost producer in the United States and it is very difficult for our industry to compete worldwide.

Last year, as you recall, Mr. Chairman, I appeared before this committee. A similar atmosphere existed in the Senate. The merger moratorium bill was being debated; the Senate rejected the bill for sound reasons.

Yet, now we are once again looking at a variety of different bills, including two that would establish moratoria. Three things relating to my activities have changed since I last testified before this committee.

The U.S. Treasury is about $2.8 billion richer in taxes that they have picked up. Six hundred thousand shareholders have made $9.3 billion as a result of the two deals that we have been involved in, Gulf and Phillips. And managements, I can promise you, are working harder in the industry.

Stockholders own companies; I think all of us would agree that they have an investment and they are perfectly capable of deciding

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whether or not they want to accept a tender offer for their stock. They can take it or they can turn it down, but we all agree that stockholders are owners of the companies.

Congress should not take any action to further entrench already entrenched management. You criticize big business in America sometimes for good reason, so why fortify managements who have actually done a poor job for their stockholders?

Managements work for stockholders just as you work for the voters. There are 42 million stockholders in corporate America today; 42 million people own stock in public-owned companies in the United States. That is 100,000 per congressional district, and these people cannot stand any more abuse; they have taken enough.

These people have put their money at risk and I say let us not play games with them. Their money is up; it is very important to them and they are entitled to a fair shake. Do not declare a moratorium or take any other action that would add greater risk to stockholder investments or deny them a chance to make a decent profit.

I will be happy to answer any questions that you have for me.

The CHAIRMAN. Thank you very much.

Mr. Pickens, it has been reported that takeovers often benefit shareholders of both the acquiring and acquired companies. Has this been the case in any of the takeover attempts in which you have been involved other than what you have just said?

Mr. PICKENS. The first takeover we had was in 1969, which was Hugeton Production Co. The company was about 20 times our size. We took the company over and actually expanded their operations, increased their drilling activity, added people to the payroll, and that was in 1969.

We had another takeover in 1973. Believe it or not, we were a white knight—it was Pubco Petroleum Co. from Albuquerque. We have since that time and more recently been in the Cities Service-Gulf & General American-Phillips deals.

In those deals, there were about 900,000 stockholders involved, and those 900,000 stockholders have made about $13 billion. The Federal Government has actually picked up in taxes something over $3 billion from those four transactions.

The CHAIRMAN. Now, Mr. Pickens, one of the consequences of some takeover attempts is the payment of the target company of a premium to the offeror in exchange for the offeror's termination of his takeover efforts. This premium payment is often referred to as greenmail.

Are there any benefits to the shareholders of either company when a takeover attempt ends in such a payment?

Mr. PICKENS. The only one that would benefit in such an arrangement as that is the one who sold his stock at a premium and left the other stockholders out, and that is identified, of course, as greenmail, as you mentioned.

I have been opposed to greenmail, as you well know. We have never received it and we have never negotiated for greenmail. We have been offered greenmail several times, but we have turned it down.

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The simple solution to greenmail would be that a board of directors would just announce that they are not going to pay greenmail to anybody, and that is it. That is all you have to do. You do not have to have a special stockholders' meeting; you do not have to have legislation. Just have a board of directors that has guts enough to just say they are not going to pay greenmail; it is that simple. It would just be a one-liner.

The CHAIRMAN. Mr. Pickens, it has been charged that the borrowing involved in some takeover attempts siphons credit away from other borrowers. How do you answer those charges?

Mr. PICKENS. Well, if you look back over the capital markets in this country, you recall a year ago that when—I cannot recall his name from Citibank, but he testified before your committee here and clearly demonstrated that it did not siphon capital away from other industries.

I do not think there is any doubt that there is plenty of capital available in the United States to lend to anything that makes economic sense. So, herein, this is not a case that a banker is looking at two different credit prospects and saying, well, this one is better than that one.

I think that if there are good credit prospects, there is plenty of capital in the United States to fund all of them that make sense.

The CHAIRMAN. Mr. Pickens, in what ways do you think takeover attempts and tender offers produce procompetitive results?

Mr. PICKENS. Would you repeat the last part of it? I did not hear it.

The CHAIRMAN. In what ways do you think takeover attempts and tender offers produce procompetitive results?

Mr. PICKENS. Procompetitive results?

The CHAIRMAN. Procompetitive.

Mr. PICKENS. I think there is no doubt in our industry—and I have a little difficulty when you take me out of the oil and gas industry—that our industry is getting more efficient all the time and part of that is due to the combinations of different companies. The efficiencies are there and the consumer will see the results.

The CHAIRMAN. I have got to go and open the Senate now at this time. Mr. Pickens, I want to thank you for your appearance. I am going to ask Senator Specter if he would take over until I get back.

Senator SPECTER [presiding]. Thank you, Mr. Chairman.

Mr. Pickens, when you appeared before this committee about a year ago, you were asked a question about the effect on your activities if interest were not to be allowed for tax purposes on the leveraging.

As I recollect, you said that this would throw a substantial crimp into the kind of operations you carried out. Was that the answer you gave about a year ago?

Mr. PICKENS. I cannot recall it. I wish I had that testimony in front of me, but my feeling is that, you know, if you do disallow the interest deduction, it would have some impact. But I do not think that these deals are driven by the fact that you can deduct interest.

Senator SPECTER. Do you think the deals would go forward if you could not deduct the interest?

Mr. PICKENS. Well, I think some would and some would not. You would just have to evaluate the deals. If there is enough margin in

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there that some deals would go forward and if it is very thin, some deals would not go forward.

Senator SPECTER. How many deals have you been involved in so far, Mr. Pickens?

Mr. PICKENS. Well, how far back do we want to go?

Senator SPECTER. Five years.

Mr. PICKENS. OK. From 1982 would be the Cities Service deal, and second after that was General American, Gulf, Phillips, and Unocal.

Senator SPECTER. General American, Gulf, Phillips, and Unocal?

Mr. PICKENS. And Unocal.

Senator SPECTER. Would all of those deals have gone forward without the interest deduction?

Mr. PICKENS. I would have to go back and look at the last two on that basis, but if you want me to speculate, they probably would have. Maybe the offer would not be as high as we had made, though.

Senator SPECTER. But there would have been at least some impact on some of your offers if the interest had not been deductible?

Mr. PICKENS. It could be, again, but I hate to go just from memory because this is not a primary factor when looking at the deal as to how the interest will be treated. It will become a point that will have to be considered some time during the analysis, however.

Senator SPECTER. Mr. Pickens, do you think that all of the hostile takeover attempts are beneficial in the marketplace or are there some, any at all, which are undesirable socially?

Mr. PICKENS. Well, now, you have covered a big question there for me. First, you said marketplace and then you said socially.

Senator SPECTER. Well, the question was intended to say that. It has perhaps a very broad sweep, but let us take it as broad a sweep as we can, obviously consistent with your knowledge.

The laws currently have a structure which permit hostile takeovers. Part of our concern is whether or not the rules and regulations which permit these hostile takeovers are wise. We want to have a free marketplace. We want to drive out inefficiency. We want to let shareholders have real value.

And yet we do not want to have rules and laws which permit business activity which is predatory—that is a loaded word—or business activity which is antisocial, which is harmful to the values of our society.

My question to you is that given the current laws which govern takeovers in the marketplace, is there any one that you can think of which was unwise from society's point of view, was not good in the interests of the public welfare?

Mr. PICKENS. I cannot. Of course, you know we have exchanged views at different times, Mr. Specter, about, you know, our feelings in the Gulf deal. But I always come from the standpoint of the stockholders; that stockholders do own the company.

And if there is an offer there, the stockholders are entitled to hear that offer. It does not mean they have to accept it, but it is their right to decide whether they want it or they want to turn it down.

Now, I understand the social aspects of it very well, and if you look back over my record as far as relationship to communities where I am located, I think my record will be A-plus—plus with employees of our company. I will stand on my record there.

But I never want to see any community disrupted by the movement of personnel or a company out of that community. And I think if you look back over the transactions that you asked me about, starting in 1982, you will see that in every case we were quite willing to combine two companies and move to the place of the larger company, which would have been Cities Service, Gulf and Phillips, also Unocal.

The fifth was General American. We were larger than they were and we would have moved their headquarters to us.

Senator SPECTER. Well, Mr. Pickens, aside from the takeover attempts which you have undertaken, do you know of any other hostile takeover attempt which was adverse from the public welfare point of view?

Mr. PICKENS. I do not know the deals outside our industry. If we speak to the oil and gas industry, I could probably—if you remind me of one, I could probably comment about it.

There again, if management is doing a good job for the stockholders, then there is no fear for the employees or the cities where they are located. The stockholders are being taken care of. Consequently, the vulnerability for a takeover is just not there.

Senator SPECTER. Well, there are interests aside from the stockholders' interests. There is the objective of exploration. One of the concerns which some of us have had relates to the social preference to encourage exploration as opposed to takeovers.

It may be cheaper to take over Cities Service to acquire their reserves or cheaper to take over Gulf and acquire their reserves than it is to go out and drill. But the public and society might be better off if the rules were modified so as to encourage exploration as opposed to takeovers.

So there are considerations beyond those of the stockholders' interests. But the stockholders' interests are important.

Mr. PICKENS. May I comment on that?

Senator SPECTER. Yes.

Mr. PICKENS. Mr. Specter, it is my feeling that there is plenty of capital in the oil and gas industry in the United States to drill economically drillable prospects. And it is not a case of a company going out of the exploration business because they have been merged, acquired, or whatever else, because those prospects are there; they are not going to go anyplace.

The oil has been in the ground for 100 million years. If we do not drill it in 1985, we might prefer to drill it in 1988 or 1995. So it is not a case that we are going to lose these prospects by not drilling them.

I am not in any real rush to finish off the last of our oil and gas resources in the United States by putting an industry in a straitjacket and saying you have got to go back out and spend your cash flow looking for more oil and gas.

I think it is up to that management to decide what they can do with the capital that is available to them and make the best use of that capital on behalf of their stockholders.

Senator SPECTER. Mr. Pickens, I had asked you the question whether there was any hostile takeover which was adverse to the public interest and you said that you could only comment on those within your own industry.

Is there any hostile takeover attempt within your own industry that you view as harmful to the public interest?

Mr. PICKENS. No, I do not know of any.

Senator SPECTER. One of the considerations which troubles some of us involves the necessity for corporations to have short-run profitability as opposed to long-term planning which may be more desirable from a company's point of view, but you cannot get into the explanations with the shareholders, as opposed to what happens in the short run.

Do you think that hostile takeovers even of the kind that you have undertaken place too much of a premium on short-run profitability of a company, which does not let management really look to the long-range benefits which might be more important, in order to look good in the short run, say, to stop a hostile takeover attempt?

Mr. PICKENS. Well, I think it is interesting that in the Wall Street Journal today, the economists over at the SEC—I cannot recall one of them, but the second one is Kenneth Lehn, and he speaks to that very clearly and quantifies it and says let us get off of different anecdotes and some of the—it is Gregg Jarrell and Kenneth Lehn over at the SEC.

They point out: get off these anecdotes and start to quantify and give the facts as to what has happened to research and development in the short term and the long term. You know, they have got so much more factual data than I have, but my feeling about it is when you start talking about R&D, if you look at the companies that have done well for the long-term, they also are companies that have done well for the short term.

An example is IBM. IBM has served their stockholders very well because they have done some very good planning. I think the long-term/short-term argument comes up because the companies that are under attack are grasping for reasons and protection and so they start yelling, we are a long-term thinking outfit and the company that is on the attack is a short-term thinker. I do not believe that to be the case at all.

Senator SPECTER. Mr. Pickens, how much money did you and your associates make on the Cities Service transaction?

Mr. PICKENS. On the Cities Service transaction?

Senator SPECTER. Yes.

Mr. PICKENS. You are testing my memory here on that one, but I do recall that all the stockholders in Cities Service made something over $2 billion.

Senator SPECTER. Two billion?

Mr. PICKENS. Yes. All the stockholders made over $2 billion; there were over 100,000 stockholders. In looking at that, let me think, but if you will let me check this and correct it, I believe I have got it

Senator SPECTER. Your memory was just refreshed?

Mr. PICKENS. I would have to check it. Well, I was pretty close. I was going to say $31 million. We made $32 million out of the trans-

action. There were 150,000 stockholders in Cities Service and their gain was $2 billion, so I was pretty close on that one.

The Federal income tax on it was $600 million, so the Federal income tax was 20 times what we made out of it.

Senator SPECTER. And your second transaction, you said, was General American?

Mr. PICKENS. Yes, General American, and I do not have that one in front of me, but it was about—we were a stockholder in General American for 4 or 5 years and we could never get the management to do something for the stockholders and we finally made an offer for them.

I believe we made about $40 million out of that and all the other stockholders made $500 million.

Senator SPECTER. And how much on Gulf?

Mr. PICKENS. I have got that one here. There were 400,000 stockholders that made $6.6 billion. We had 404 million, pretax, and the Federal Government made $2 billion.

Senator SPECTER. Phillips?

Mr. PICKENS. Phillips was—there were 30,000 stockholders that had a gain of $4.7—wait a minute, wrong line. Phillips, 200,000 stockholders that had a gain of $2.79 billion. We had $89 million in profit and the Federal Government had $837 million.

Senator SPECTER. And what do you anticipate as to Unocal?

Mr. PICKENS. I do not have any projection on that.

Senator SPECTER. Thirty-two and 40 is 72; 404 is——

Mr. PICKENS. I can give it to you here; I have got the totals.

Senator SPECTER. I wanted to add it up slowly, Mr. Pickens.

Mr. PICKENS. OK.

Senator SPECTER. $565 million.

Mr. PICKENS. No; it is 525. It is 32, 404, plus 89.

Senator SPECTER. Well, you left out the 40. Now, why did you leave out the 40?

Mr. PICKENS. OK. I did not have that for sure as far as General American. You are right.

Senator SPECTER. Mr. Pickens, you have made my day. I got a figure correct in competition with you. I think I am going to change professions.

Mr. Pickens, this question——

Mr. PICKENS. You did not add up the one on Federal income taxes.

Senator SPECTER. I was not obligated to, Mr. Pickens.

Mr. PICKENS. Let me help you on that one. That would be about——

Senator SPECTER. Wait a minute, Mr. Pickens. As soon as you can ask the questions, I will answer the questions. Let us stick with my questions.

Mr. PICKENS. OK, fine. I thought maybe you would let me give you the number.

Senator SPECTER. You talked me into it; go ahead.

Mr. PICKENS. Four billion dollars.

Senator SPECTER. Mr. Pickens, this question is going to surprise you, but do you think you and your associates were worth $565 million in the American free enterprise system for what you did here?

Mr. PICKENS. Well, let us talk about our position here. We were the largest stockholders in those companies and we did make huge investments. I would like to, if I could, go over three deals that were done in 1984, which were the Texaco-Getty deal, the Chevron-Gulf deal, and the Mobil-Superior deal. Now, there was a common denominator in all three of those transactions.

Senator SPECTER. Texaco-Getty, Chevron——

Mr. PICKENS. Chevron-Gulf and Mobil-Superior. The common denominator was that there was a large stockholder in each one of those companies that was disenchanted with what management was doing in behalf of all the stockholders.

All of them had huge investments in the companies. Gordon Getty over at Getty Oil decided he did not like the way it was going. The stock was selling at $50. He put the company up for sale and it sold for $128 a share to Texaco.

You had Howard Keck over at Superior; he also was unhappy with the management of Superior, so he put the company up for sale and sold it out to Mobil and the stock price went from about $34 to $45.

Now, there was another stockholder that did not like what was going on, which was a Gulf investors group in the Gulf deal. So in all those deals, it is interesting that never did I hear Gordon Getty identified as a predator, raider, greenmailer or anything else, nor was Howard Keck. But it is commonplace to call me a predator after we went out and put up $1 billion in the Gulf deal, took our chances.

We could have lost, you know, in the whole situation, and we did make something happen and a lot of shockholders got a tremendous gain. Second, we were the last ones that were paid in the Gulf deal. Eighty-seven percent of the stock was picked up, paid for, and we were the last 13 percent to get paid in the Gulf deal by Chevron.

So, here, you have an unusual situation. You have two long-time holders, Howard Keck of Superior and Gordon Getty of Getty Oil, that had zero basis in their stock. Over at Gulf, we had $1 billion invested over there. All of us saw the same thing; we did not like what was going on with the management, so we did force changes.

Senator SPECTER. Mr. Pickens, I take that to be a yes?

Mr. PICKENS. Yes.

Senator SPECTER. My question was, as I am sure you recall, whether you were worth that much money, you and your associates. I do not disagree with your answer, considering it is a yes answer. I do not disagree with it. You have operated within the laws of the land and I think that you have demonstrated that many of the companies, perhaps all the companies, were grossly undervalued. But there are many troubling aspects which I do not think we fully understand in the Congress.

I have a strong sense that many of the takeovers are predatory and are undesirable and that we are at loose ends on the matter. The situations with Gulf and Chevron have resulted in widespread disruption in my State as a result of what has occurred there with the closing of headquarters in Pittsburgh and laboratories being moved, and now the imminent problem of the refinery in Philadelphia.

Mr. PICKENS. Mr. Specter, you remember that whether you wanted me or not, I said that I would move to Pittsburgh and run the company from there, if we took it over.

Senator SPECTER. Before who took it over?

Mr. PICKENS. I said if we had taken it over, we would move to Pittsburgh, leave the headquarters in Pittsburgh. The management of Gulf Oil selected—out of four options they selected—the only one that would have moved Gulf Oil out of Pennsylvania.

Senator SPECTER. Mr. Pickens, I remember that very well and I thought that that was perhaps the most desirable of the alternatives facing Pittsburgh at that time. I could not control that, obviously, and even you could not control that and what has happened has happened.

We have had a major shift now in Arco. I have not gotten all the details, but as I understand it, Arco is going to close its marketing and refinery operations in the eastern part of the country, is making a major reevaluation of its assets, and is borrowing substantial sums of money to buy its own stock.

We are experiencing enormous turbulence in the marketplace and it is having dire, cataclysmic consequences on existing patterns of living in States like mine. I do not think we have any major installations in the central part of the State to be altered like this.

The question comes up, aside from the range of the shareholders' interests, and there are other interests, whether the things going on are in the national interest. Your answer is that it is desirable in all respects?

Mr. PICKENS. Are we talking about Arco now?

Senator SPECTER. Well, Arco, Gulf, the whole picture. It is all part of an evolving pattern of hostile takeovers.

Mr. PICKENS. Arco is not under any pressure to restructure. I think they did that totally on the basis of studies that they made internally and decided it was in the best interests of their stockholders.

They put $3 billion in market value in that company in about ten days.

Senator SPECTER. I believe that they were looking over their shoulders, Mr. Pickens, at you or others as to what was likely to happen. I think that——

Mr. PICKENS. I do not agree with you.

Senator SPECTER. Why not?

Mr. PICKENS. Why would they be looking over their shoulders at me? I am up to my armpits in a deal right now with Unocal. There is no way in the world I could be looking at Arco.

Senator SPECTER. You may be down to your ankles in a few days and then looking at somebody else, or there may be somebody else who will be looking at Arco.

Mr. PICKENS. Well, again, you know, if managements are not getting the job done for the stockholders, remember that, you know, a stockholder can take an offer or turn an offer down, and I do not think that the Congress of the United States should be stepping in and telling somebody that they cannot look at an offer. If an offer is made to them, they should have the right to decide whether they want it or not.

We are going a long way in the free enterprise system if we start taking that away.

Senator SPECTER. Well, Mr. Pickens, I quite agree. It is just a question on my mind as to whether there is some regulatory process which ought to come into play here in some respect, and we have not quite gotten it all sorted out yet, but the pace is very fast and furious and I have an instinct that we ought to be putting the brakes on at least some of these activities, and I am not saying which one.

Mr. PICKENS. Well, I can understand your concern about Pennsylvania and I can understand your concerns about Arco's refinery at Philadelphia. But, again, I mean these people have a fiduciary responsibility to run a company as best they can.

I would suppose that the reason they are shutting down those facilities, if they are—I saw where they were going to sell their service stations east of the Mississippi and all. I would imagine if you got in and looked at the numbers, you will find that they probably are not doing well with those operations. Maybe somebody else can do better with them.

But, eventually, if an operation is not doing well, it is going to be closed down. Some go longer than others because some managements are more patient than other managements are, but eventually if you have an operation, if it is a refinery in Philadelphia or whether it is in Okeene, OK, or wherever else it is, it is going to be shut down eventually if it is not going to make money. Now, you know, we both know that.

Senator SPECTER. Thank you. Do you have——

Mr. PICKENS. You know, I have compassion for your problem. I never want to see anybody put out of a job, but I do think that we should be realistic. When we do have operations that are not producing a profit, you are not going to continue to run them. That is just not the way business is in America. You are not going to run it just because you want to create jobs, but you do not make any money.

Senator SPECTER. Well, I quite agree with you on that. The concern I have is whether or not there ought to be some fine-tuning which could allow the marketplace to function and allow for the stockholders' interests, but still not give way for hostile takeovers which are harmful to the public welfare. Thank you.

Mr. PICKENS. OK, thank you.

Senator SPECTER. Thank you, Mr. Chairman.

Senator NICKLES. Mr. Chairman, I am wondering if I might ask our witness just a couple of quick questions?

Senator SIMON. Unfortunately, I am scheduled to be——

Senator NICKLES. Excuse me. I thought you had already spoken.

Senator SIMON. No.

Senator NICKLES. Go right ahead.

Senator SIMON. Ordinarily, I would be pleased to yield to the gentleman from Oklahoma, but I do have——

The Chairman [presiding]. Senator Simon.

Senator NICKLES. Go right ahead.

Senator SIMON. Just a couple of quick questions. First, for the staff of the gentleman from Pennsylvania. If he is thinking about legislation or amendment to eliminate the interest deductibility in

some of these huge mergers, I think that might be a small step in the right direction.

If I could ask you to reverse roles here, Mr. Pickens, you are a member of the U.S. Senate. You see the productivity of this country relative to the productivity of Japan, West Germany, and a lot of other countries slipping, and you see the latest statistics just a few days ago—a 1.2 percent drop in productivity in this country—and you recognize that a lot of the money we are spending is not to increase productivity, but just to see one company gobble up another company and adversely impact the credit market in the process, keep interest rates high.

What would you be doing as a U.S. Senator about that situation?

Mr. PICKENS. Well, I do not agree with your assumptions, to start with. I do not think you are keeping interest rates high because of takeover activity. I do not believe that to be the case at all.

But, second, you have got me in a tough spot here.

Senator SIMON. Let us take your first place where you disagree with my assumption. There is no question that we are spending what was borrowed just in the oil field, forgetting everything else, in takeovers and used up in the capital market in that area last year?

Mr. PICKENS. I do not know what the number is. I am sorry; I just do not have it.

Senator SIMON. But it was something like 36 billion or something like that, is that not roughly correct?

Mr. PICKENS. I do not recall. I will accept your figure. I honestly do not recall what it is.

Senator SIMON. I am not sure that the 36 billion figure I am using is correct either.

Mr. PICKENS. I am not either.

Senator SIMON. But whether it is 36 or 26 or 46, that is just like adding another 26 or 36 or 46 billion to the deficit as far as the credit markets are concerned

Mr. PICKENS. No, it is not either. Those are very well collateralized loans, I can assure you. I serve on two bank boards and we are constantly looking for good loans. We have plenty of money to loan at those banks, if we had good places to loan the money. So it is not a case that we are using up credit that could go someplace else.

Senator SIMON. Well, except the United States sometime this summer is going to pass Brazil as the No. 1 debtor nation of the world because we are borrowing from other countries. If present trends continue, in the next 3 years we will have more foreign debt than Brazil, Argentina and Mexico combined. Now, that concerns me, frankly.

Mr. PICKENS. It does me, too; it does me, too. But the loans we are talking about here for these particular companies are sound loans; very easy to demonstrate that they can be amortized over a reasonable period of time. We are not talking about weak loans; we are talking about really sound collateralized loans.

Senator SIMON. I am not suggesting that the loans are not sound. What I am suggesting is from the viewpoint of the economy, it is not sound to be soaking up credit in this way that does not add to the productivity of the country.

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Mr. PICKENS. I do not agree it is soaking up credit that way. I mean, the reason you have got high interest rates is because the interest rates are set by the Fed. There is plenty of money in the banks today in the United States to be loaned out on sound, creditworthy loans. I know that; I am sitting there looking at them. I know what I am talking about.

Senator SIMON. I think you and I have a basic difference of opinion. Let me shift to another area where maybe you and I can agree, greenmailing. I just heard you say you have never been involved in that.

Is there any reason we should not pass legislation prohibiting that in this kind of a takeover situation?

Mr. PICKENS. Well, if you cannot get the boards of directors of public-owned companies to show the discipline to just say we are not going to pay anybody greenmail—if you cannot get them to just come out and make an announcement of that, then I would say legislation is in order to be sure that greenmail should not be paid.

I have said time after time that we at Mesa would never pay anybody a premium to buy their stock back. If anybody makes an offer for Mesa Petroleum, that offer is going to go directly to the stockholders. There will be no legal maneuvering.

There will not be one dime spent to head that offer off to the stockholders. In conversations that I have had recently with Congressman Wirth from Colorado, I said if you are going to have legislation, just put one line in there that a company cannot pay a premium to market for anybody's stock unless they offer it to everybody in the company.

Now, we are just going through that in the Unocal deal. Can you imagine that in this case the board of directors of Unocal said we will pay $72 a share for 50 million shares of stock at Unocal, but Pickens and his group will be left out? Now, why are we left out? Our stock certificate looks just like everybody else's, and that is exactly what the Delaware court ruled on Monday. Yes, the offer has to be made to all the stockholders.

Now, they are appealing that, and this is terribly expensive for stockholders. I am confident of exactly how the appeal is going to go. It should have never been done in the first place. If you are going to make an offer, make it to everybody.

You know, I agree that greenmail should not ever be used.

Senator SIMON. You and I are in agreement on that. Let me ask about one other area that has not been touched upon and then, Mr. Chairman, I have to go to another meeting, but I want to get back here. I commend you for holding hearings on this.

What about the golden parachute? Does that bother you at all?

Mr. PICKENS. Let me tell you exactly how we have said that we will handle the golden parachute, which is an extension of salary in the event there is a change of control. I have said that if anybody makes an offer for Mesa Petroleum, I will not take any extension of my salary beyond the day that they move me out of that office.

I do have a golden parachute in the event—it would be used in a countertender offer context wherein we would go for you, you would come back for us. Then we do have some protection on that and we do have some shark repellants.

But if you make an offer for Mesa Petroleum today, the shark repellants go and my extension of salary is out because the stockholders own the company and they should have the right to decide whether they want to take your offer or not. They may turn you down and they may not.

I think golden parachutes is just another device that management has total control over that they can go in and ask for those kinds of things and get extensions. Of course, the Gulf deal was the most unusual that I have ever seen.

If I might just tell you a quick story on that, Jim Lee, their chairman, asked me if I would go along with their acceleration of stock options. I said yes, I think you are entitled to an acceleration of stock options in a change of control.

I did not know—and that happened to be $52 million to the executives at Gulf Oil—I did not know, and it was never mentioned to me until I found it in the offering document, that Chevron matched the $52 million. Why? I do not know. I still do not understand why Chevron would give the executives at Gulf Oil $52 million. I will leave that to your imagination as to why.

Senator SIMON. Well, let me just say, while I disagree with Mr. Pickens on some things, I think one of the things that he has caused is a reexamination by management not only in the oil fields but in a lot of other areas, and I think in that area you have made a real contribution.

Mr. PICKENS. Thank you.

Senator SIMON. Thank you, Mr. Chairman.

[Prepared statement follows:]

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STATEMENT OF T. B. PICKENS, JR.
PRESIDENT AND CHAIRMAN OF THE BOARD
MESA PETROLEUM CO.

Mr. Chairman and members of the Committee, I am Boone Pickens, chairman and president of Mesa Petroleum Co. I appreciate the opportunity to appear before you today.

While I am not an expert in antitrust law, I do understand the oil and gas business, in which a portion of recent takeover activity has occurred. I am here to outline the underlying reasons for this restructuring in order to show that it is healthy for the industry, consumers, stockholders and the economy. Because restructuring will increase efficiency and invigorate competition, there is no need for new antimerger or antitrust legislation.

For the reasons outlined in my testimony, I urge the Committee to move cautiously in considering the pending legislation and to reject piecemeal attempts to stop takeovers by changing antitrust requirements or enacting merger moratorium bills, such as S.473, which has been referred to this Committee, and S.975, the Securities Safety and Soundness Act of 1985. Such attempts assume, against the great weight of evidence, that hostile tender offers and mergers are bad per se. They ignore the overwhelming benefits that accrue to the consumers, the American economy and to its key participant, the shareholder. Unfortunately, these bills serve only to protect and entrench managements, often to the detriment of shareholders.

The restructuring taking place today in the energy industry has developed as a result of the need of companies to replace economically reserves that are diminishing. The restructuring plan announced by Atlantic Richfield Co. earlier this week speaks directly to the issue. ARCO is addressing the problems facing our industry and maximizing values for all shareholders at the same time. This makes good sense. The company will purchase $4

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billion of its stock, sell portions of its refining, marketing and non-oil operations, reduce operating expenditures, write off $1.3 billion against 1985 earnings as a result of the restructuring, and increase its dividend by 33 percent.

Recent cutbacks in exploration and drilling have occurred because of today's economic realities: good drilling prospects are scarce, finding costs are high and energy prices are dropping steadily. In short, many prospects are no longer economic. The industry must restructure to adapt to these developments.

Antitrust and antimerger legislation will impede this natural process. Recent analyses of energy mergers by the Federal Trade Commission (FTC) and the Justice Department show that concentration of ownership in the industry is low.

In fact, during Senate debate last year on oil company merger moratorium legislation, it was clearly demonstrated that the oil industry is not concentrated in terms of the percent of the market held by the larger companies. In general, there are a large number of participating companies. It was noted that there are about 10,000 active exploration companies, over 130 separate companies that own and operate refineries, and approximately 15,000 wholesalers and numerous independent trucking companies. In addition, the majority of the nation's 140,000 gasoline station outlets are operated as separate businesses by independent dealers.

In testimony before the Senate Committee on Energy and Natural Resources last year, the FTC noted that in terms of the merger guidelines, the overall crude oil market clearly would not fall into the strictest "highly concentrated" category. The four largest oil companies have far less than a 75 percent market share. Combining the reserves of the top eight companies totals only 44.5 percent of all known U.S. reserves. Even after the Texaco-Getty and Socal-Gulf mergers were completed, the principal segments of the U.S. petroleum industry -- oil production,

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natural gas production and gasoline sales -- would have concentration ratios below 35 percent with the refining segment at 35 percent. Hence, they still would be less concentrated than the majority of U.S. manufacturing industries.

The Washington Post and a number of other respected commentators acknowledge oil markets are "genuinely open." The energy industry is extremely competitive.

As a natural function of the free market, mergers and acquisitions bring about innovation and growth. Legislation designed to stop takeovers insulates and perpetuates bad management and fuels inefficiency.

Corporate management already possesses the best possible defense against hostile takeovers: the ability to improve the company's performance. Why should Congress relieve management from concentrating on the bottom line?

Instead, Congress should look to a much larger constituency -- the shareholders. As the cornerstone of the free market, their interests are paramount. Forty-two million Americans own stock in our public corporations, according to a 1983 New York Stock Exchange survey. That is one out of every six Americans or more than 100,000 voters in each Congressional district in the United States. About half of these people have portfolios of less than five thousand dollars. They have put their money into the hands of management with the expectation that management will do its best to keep their investment's market value as close as possible to its true value.

If investors are dissatisfied with management performance, they have several options. One is to sell their stock. Restrictions on legitimate tender offers would deprive these investors of that basic property right.

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This type of unnecessary restriction on a shareholder's right to sell their property is found in S.473 and S.975. S.473 is virtually identical to legislation which the Senate rejected last year. S.975 accepts S.473's faulty premises and is even more destructive of our capital markets, in many respects.

In an effort to deal with a perceived problem with high yield bonds that has yet to be demonstrated, S.975 would not only stop many hostile mergers but also deprive shareholders of the right to sell their stock and seek the greatest return on their investment. This bill stops the needed competition between managements that occurs during a hostile takeover and ties the hands of shareholders who simply want to sell their stock. This is more dangerous than the energy company merger moratorium bill that was soundly defeated by the Senate last year. Its scope is not limited to the energy industry or to mergers; the simple acquisition of stock by any bidder considered by management as "hostile" is barred. Does the Senate really intend to aid ineffective management through legislation that would serve only to entrench them further and give them no reason to be responsive to the interests of their shareholders?

If legislation restricting mergers and tender offers such as S. 473 or S. 975 is ever enacted into law, the Securities and Exchange Commission should, in the interest of fairness and full disclosure, require that all stock certificates contain an appropriate boldface legend: WARNING: IT'S THE LAW -- YOUR ABILITY TO REALIZE THE HIGHEST PRICE FOR THESE SHARES IS SEVERELY RESTRICTED.

In expressing concern over the plight of the shareholder, Mr. Robert Bleiberg asks "Who speaks for the silent majority?"[1/] Mr. Chairman, in this capitalistic society the shareholder is our

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1/ Barrons, January 14, 1985.

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constituent, just as the voter is your constituent. We listen to our constituents. We work for them. We try hard to increase the value of their investment in Mesa and, if we fail, we expect to be voted out of office, just as you do.

Pending legislation would limit shareholders' opportunity to recover full value of an investment because it makes mergers more difficult. It is my understanding that the antitrust laws were established in order to protect the consumer and to promote competition. Making mergers more difficult may, in fact, lessen competition by preventing the emergence of new major competitors. Further, the antitrust enforcement authorities scrutinize each merger on its merits. Broad, prohibitory anti-merger legislation would hamper that flexibility.

Oftentimes a takeover is the only way, or at least the quickest way, of dislodging a management that is unresponsive to market developments and therefore unresponsive to shareholders. Management efficiency can arise from better utilization of the acquired firm's resources. Management can lose its competitive edge to the luxuries of perceived success -- ever growing perquisites and excessive free time away from company matters. Whatever the reason, it is important that stockholders not be burdened with a management that cannot face up to or handle current problems.

The mere threat of a hostile takeover attempt can perform a desirable disciplinary function and foster enhanced corporate accountability to the shareholders. Management must never be allowed to become complacent or to forget who really owns the corporation. One commentator has asserted that the "market for corporate control may be the only serious force for limiting management discretion."2/

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2/ Gilson, A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers, 33 Stan. L. Rev. 819, 841 (1981).

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In my view, the Economic Report of the President, at page 189, states the case succinctly and correctly:

> "The best assurance an incumbent management has against a successful takeover attempt is a stock price that is high relative to outsiders' estimates of the potential value of the corporation's shares. Managements that allocate capital to higher valued uses, operate efficiently, and adopt capitalization structures responsive to prevailing financial market conditions are less likely to be subject to takeover than other management groups. Consequently, in order to prevail in the external market for corporate control, it is not enough that an incumbent management believes that it is doing a proper job, or that it persuades stockholders that it is doing so. Instead management must demonstrate that its performance is competitive with the performance of other potential managers, and the value of management's performance must be reflected in the corporation's stock price."

The Economic Report concludes:

> "The public has a legitimate interest in the continued strength and vitality of the market for corporate control. Publicly traded corporations account for a substantial portion of the nation's wealth and productive capacity, and it is important that the management of these firms not be insulated from competition in the market for corporate control. The available evidence is that the operation of this market has generated net benefits for the economy. The evidence also suggests that abusive practices in the market for corporate control are limited largely to tactics employed by target managements who, in opposing takeover bids, defeat or deter tender offers at the expense of their stockholders and the economy."

> "Remedies for these abuses can often be fashioned within the corporation itself. Stockholders also have recourse to the courts which have recently indicated a willingness to subject target management conduct to closer scrutiny. In addition, abusive conduct by corporate management has traditionally been subject to State regulation; the available evidence indicates that federalism has served stockholders well. Accordingly, further Federal regulation of the market for corporate control would be premature, unnecessary, and unwise." (Emphasis added.)

If we need anything, it is legislation to protect shareholders and consumers from wasteful takeover defenses like the "poison pill." This is an entrenchment device that managements use to protect themselves against hostile takeovers. It deprives shareholders of their basic right to cash in on their invest-

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ment. If used on a large scale, it could place control of corporate America in the hands of a few people, giving them the power to block the free flow of capital.

Too often, entrenched managements try to lock up capital for their own selfish interest. We do not need legislation to protect these individuals, nor do we need legislation to protect the small business competitor.

When Unocal Corporation recently announced it would buy back approximately 30 percent of its stock for $72 per share in notes, but would not accept stock offered by the Mesa investor group, a horrible example of management entrenchment was set. In attempting to exclude Mesa, the Unocal management showed its true intent to preserve its power at the expense of the shareholders.

Two days ago, the Court of Chancery in Delaware struck down Unocal's attempt to discriminate against shareholders and ordered the company to include Mesa in its $72 offer. Unocal's "selective exchange" offer clearly was a form of greenmail pushed to the extreme by a self-serving management.

Mesa is a prime example of a small company that has grown not only through successful exploration, but through acquisition. Five years after incorporation in 1969 (with total assets of less than $2 million), Mesa tendered for and acquired another public corporation engaged in the production of hydrocarbons. This company was 20 times the size of Mesa. It was quickly assimilated into Mesa and the combined financial and human resources fueled the company's rapid growth.

Several years later in 1973, Mesa acquired another company as a white knight, and the procedure was repeated. In each instance, efficiencies of operation were greatly improved and return on shareholders' investments was enhanced.

We proved that through acquisitions, a larger and more

profitable company could emerge. The expanded exploration budgets made possible by the business combinations made us a stronger company with greater long-term vitality. These acquisitions provided both short- and long-term value to our shareholders.

Each year since its inception, Mesa has replaced and enhanced its reserve base. Replacement has been achieved primarily through intensive exploration and development. We have invested over $1.8 billion in offshore exploration and development in the Outer Continental Shelf and have an average interest of 30 percent in 50 offshore platforms. During the last five years, total additions to Mesa's liquid reserves before acquisitions represented 139 percent of production and additions to natural gas reserves represented 187 percent of production. Our total assets today are approximately $4 billion, and our net income last year was $254 million on revenues of $413 million.

In 1981, our capital budget was $420 million; this sum was twice our cash flow. In 1982, the budget was $320 million -- still in excess of cash flow; in 1983 it was $223 million; and the 1984 budget was $110 million, excluding the $500 million purchase of proved reserves (Mesa Royalty Trust). The 1985 budget is $90 million. This current budget represents about 40% of our cash flow, which percentage is consistent with practice in the industry. Our decision to bring capital expenditures in line with cash flows was a calculated decision based upon our concern over the near-term future of the oil and gas business. It had no relation to our having created royalty trusts or our having invested in other energy companies.

The most recent data covering the Fortune 500 companies shows that Mesa would be included in the top five energy companies in assets and net income per employee, and in net income as a percent of stockholders' equity. An investor who purchased 1,000 shares of Mesa for $10,000 when the company was founded in 1964, as a result of the stock splits and the creation

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of two royalty trusts, would now have an investment with a market value of approximately $312,000.

In addition, Mesa ranks as the second largest independent oil and gas company in the U.S. on an equivalent BTU basis. The company reached its all-time production high in January of this year and topped it in February, producing 365 MMCFPD of gas and 11,967 BPD of oil and liquids. Mesa has the capacity to produce 500 MMCFPD.

Mesa's management understands that shareholders are the cornerstone of corporate America because they are the people who risk their money to invest in business. Mesa stock is valued by John S. Herold at $19 per share and on April 29, 1985, its closing price was 17 1/4, about 90 percent of its appraised value. Our market price as compared to appraised value is strong because of our entrepreneurial management.

In the January-February 1985 issue of the Harvard Business Review, Professor Michael Jensen, who is one of the foremost academicians studying mergers and acquisitions, finds that corporate takeovers convey wealth to shareholders and use assets efficiently. He states that, "Corporate takeovers do not waste resources; they use assets productively. Takeovers do not siphon commercial credit from its uses in funding new plants and equipment."

The Senate Committee on Energy and Natural Resources studied this issue extensively last year. ("Impact of Oil Company Mergers," reported to the United States Senate, prepared by the Majority Staff of the Committee on Energy and Natural Resources, United States Senate, July 1984.)

Permit me to quote from some of the conclusions of the Majority Staff's report:

> "[T]he acquisition of one company by another is purely a financial transaction.

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> One type of financial asset is exchanged for another. Cash is exchanged for the equity shares of the acquired company, and the equity shares represent ownership of existing capital. A merger or acquisition does not create a new addition to total outstanding credit, as contrasted to borrowing cash to acquire real new capital, such as a new manufacturing plant." (p. 19)

> "Thus, the borrowing required for a corporate acquisition does not impose net new credit demands on the system, and it does not withhold credit from competing borrowers. The reason is the fact that the shareholders of the acquired company invariably reinvest the proceeds from the sale of their equity shares. Such investment injects the funds back into the credit markets, either directly through an institution that lends the invested funds, or indirectly through investments in securities that displace borrowed funds. The fungibility of money assures that the investments by the shareholders of the acquired company will flow back into the money markets or capital markets where they would be available to finance credit needs." (p. 19)

Professor Jensen also labels as "folklore" the notion that shareholders are somehow harmed by takeovers. He found that target company shareholders gain 30 percent from tender offers and 20 percent from mergers. Target shareholders also were shown to gain 8 percent from proxy contests. Contrary to another myth, Jensen indicates that the shareholders of acquiring companies gain about 4 percent from tender offers and suffer no harm from mergers.

On a more general basis, the matter of whether shareholders benefit from the tender offer process was discussed by Frank Easterbrook and Gregg Jarrell, members of the SEC Advisory Committee on Tender Offers, in their statement attached to the Committee's report. Their statement made the following observations:

> "We start from the position, backed up by evidence detailed in the Appendix, that tender offers benefit shareholders of both bidders and targets. The premiums paid to targets do not just come out of the hide of bidders' stockholders; there is a gain when the bidders and targets are evaulated as a unit." (p. 2)

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> "The premiums reflect real gains to society as well as investors. Stock prices reflect the anticipated future dividends of the stock (including profits distributed in a "final" dividend, such as the payment accompanying a merger). Profits and dividends, in turn, increase when a firm becomes more efficient or better at producing what consumers want to buy. Higher stock prices thus are based on social as well as private gains. Perhaps the gains observed in tender offers come from the fact that bidders' managers make more efficient use of the targets' resources than the targets' managers do." (p. 3)

Mesa's own experience is quite positive. Shareholders of companies Mesa has sought to acquire, as well as Mesa's shareholders, have benefitted from the tender offer process. The analysis found at the conclusion of my prepared statement includes two of the tender offers in which Mesa has been involved as well as one in which Mesa was not involved as an offeror. This evidence clearly demonstrates the gain in value to shareholders.

Divestitures and spinoffs resulting from a takeover or efforts to maximize shareholder value frequently place assets in smaller, more focused companies. According to Joseph Wright, Deputy Director of OMB, in his recent testimony before the House Energy and Commerce Committee, the assets often move to stronger hands. A takeover that leads to divestiture can be beneficial to the parent company, the buyers of the divested operations and the economy as a whole.

Fundamental to the quality of the investment is a balance between short- and long-term value without unnecessarily sacrificing one for the other. Competition is the best method to generate long- and short-term performance because it spawns innovation. And innovation is essential to the growth of our economy. Mergers and acquisitions promote the innovative use of assets, thus they are a positive element of American business. Professor Jensen supports this view (pg. 114):

> "The adoption of new technologies following takeovers enhances the overall real standard of living but reduces the wealth of

> those individuals with large investments in older technologies. Not surprisingly, such individuals and companies, their unions, communities, and political representatives will lobby to limit or prohibit takeovers that might result in new technologies. When successful, such politics reduces the nation's standard of living and its standing on international competition."

I'd like to make one final comment concerning competition and Mesa's experience in the mergers and acquisition process. We strongly believe that the only issue regarding competition to raise in the context of mergers and acquisitions is whether entrenched management will be allowed to take anti-competitive steps in order to protect their jobs and perks. One concern is that the focus of this anti-competitive pressure is often banks who must exercise their fiduciary obligations as trustees for pension funds whose interests in tender offers is substantial. Moreover, banks may receive pressure from business interests to distort the tender process in an anti-competitive manner.

For example, in January of this year Unocal Corporation brought pressure on the Security Pacific National Bank of Los Angeles and forced this Bank to withdraw from Mesa's September 1984 Credit Agreement with the bank. In March, Unocal filed suit against Security Pacific as part of a plan to harrass and pressure Mesa's banks and send a clear message to the financial community to stay away from participation in Mesa credits.

To be certain the banks received the message, Unocal caused copies of their complaint to be delivered, in plain brown envelopes without cover letters, along with a news release, into the homes and offices of several directors and officers of banks throughout the country. Most of these banks had participated in Mesa credit arrangements in the past.

Thus, it appears those who want to prevent Mesa and other shareholders from asserting their rights and demanding greater corporate responsibility to shareholders have communicated in an organized manner to bank executives in the major banking centers

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of this country. As a result, no major bank in the country's financial capital -- New York City -- or in another major money center -- Chicago -- has participated in the Mesa credits arranged in connection with the Unocal tender offer. If any antitrust issue needs to be examined, it is the issue of whether true competition between managements will continue to exist in this country.

Any legislation that would impede the takeover process would be contrary to the best interest of stockholders, consumers, and the economy as a whole, and should not be enacted.

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ANALYSIS OF SELECTED MERGERS

| | J. S. Herold Value Per Share | Pre-Merger Price Per Share | Stock Price All-Time High (Year) |
|---|---|---|---|
| Cities Service | $ 97 | $ 30 | $ 68 (1981) |
| Gulf | $114 | $ 40 | $ 54 (1980) |
| Getty | $153 | $ 69 | $109 (1980) |
| Phillips | $ 79 | $ 35 | $ 63 (1980) |
| Unocal | $ 74 | $ 33 | $ 56 (1980) |

| | Offer Price Per Share | Sell-Out Price Per Share | Percentage Increase Over Pre-Merger Price |
|---|---|---|---|
| Cities Service | $ 45 (Mesa) | $ 52 | 73% |
| Gulf | $ 65 (Mesa) | $ 80 | 100% |
| Getty | $128 (Texaco) | $128 | 86% |
| Phillips | $ 60 (Mesa) | $ 53 | 51% |
| Unocal | | | |

| | Number of Shareholders | Gain to Shareholders (In Millions) | Gain to Mesa | Federal Income Taxes |
|---|---|---|---|---|
| Cities Service | 150,000 | $ 2,000 | $ 32 | $ 600 |
| Gulf | 400,000 | $ 6,600 | $404 | $2,000 |
| Getty | 30,000 | $ 4,700 | N/A | $1,600 |
| Philips | 200,000 | $ 2,790 | $ 80 | $ 837 |
| Unocal | | | | |
| TOTAL | 780,000 | $16,090 | $525 | $5,037 |

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The CHAIRMAN. The distinguished Senator from Oklahoma.

## STATEMENT OF HON. DON NICKLES, A U.S. SENATOR FROM THE STATE OF OKLAHOMA

Senator NICKLES. Thank you, Mr. Chairman. I appreciate your cooperation. I have a statement and I will ask your consent to have the statement put into the record.

The CHAIRMAN. Without objection, we will put your entire statement in.

[Opening statement of Senator Don Nickles follows:]

OPENING STATEMENT OF SENATOR DON NICKLES

Mr. Chairman and Members of the Committee: There appears to be strong support for restricting the proliferation of corporate takeovers, especially those deemed to be "hostile". The question remains, however. . . . What is the best approach?

The bills introduced into this Congress cover a wide variety of ways to deal with the situation. I have sponsored and cosponsored legislation which would either place a moritorium on hostile acquisitions or tighten the tax laws governing the transactions of mergers and acquisitions. As one who strongly supports the free-market approach to economic growth, it is difficult to craft legislation which addresses the appropriate relationship between our laws and the right of free enterprise to conduct its own affairs.

In the past, I have made it clear that I had strong reservations about the mergers that were taking place and I indicated that I would much prefer that some of the merged companies remain independent. As you are aware, many of these mergers and acquisitions have had a direct impact upon the economy and well-being of Oklahoma. The most recent and notable of which is Phillips Petroleum.

In response, I have introduced legislation which would disallow the deduction for interest incurred in certain hostile takeovers and impose an excise tax on greenmail. The critical element in all these proposals is the definition of a hostile takeover situation. In addition, I have sponsored S. 473 which would place a 6 month moritorium on the acquisition of large domestic petroleum corporations.

This moritorium would apply to domestic petroleum corporations whose oil and oil-equivalent production exceeded 20,000 barrels per day. The level of control proposed by the acquiring entity would have to exceed 4 percent of the stock, share capital or assets of the target corporation. Lastly, the disapproval by a majority of the independent board of directors would be necessary to designate the takeover as hostile.

My colleague, Senator Domenici, has introduced legislation which would impose a moritorium on takeovers which involve a significant amount of "junk bond" financing. Both his approach and mine are in response to the same problem of unconstructive corporate acquisitions, they simply approach it from two different angles.

In either case, it is very important that such a moritorium does not prohibit acquisitions and mergers which would serve the best interest of the acquired company, the majority of stockholders, or the national economy. Any moritorium which would be imposed across-the-board would be opposed by myself. Such a moritorium should be targeted only to those situations which will cause the greatest economic dislocation.

If we provide a definition that is too tight, we run the risk of discouraging the efficient and productive use of corporate assets where there is a reasonable measure of agreement between the companies involved. In a review of recent acquisitions, we see some proposals that are initially hostile and eventually turn friendly. We must allow for this type of change in any legislation that is passed by the Congress.

I realize this task is extremely difficult in the ever-changing environment in which corporate takeovers take place. However, as the method used in takeovers changes to avoid certain tax and regulatory consequences, the code must be revised to accommodate such changes.

Senator NICKLES. I appreciate it. I also appreciate your holding this hearing and the distinguished group of witnesses. As you know, I have introduced some legislation, S. 476 and S. 420 which denies interest on loans for hostile takeovers and puts an excise tax on greenmail profits. I have also cosponsored Senator Domen-

ici's bill, S. 975 which is designated to stop hostile takeovers by taking measures against the sale of so-called junk bonds needed to finance hostile corporate takeovers. I am not sure which approach is best. Some of them, I think, have some merit. I think the intent has some merit. What we must do is pick the best method to thwart hostile takeovers which cuts jobs and weakens the economy.

With Mr. Pickens here, I would like to ask him a brief question. In the first place, Mr. Pickens, I will tell you that I concur with a lot of your statements in trying to protect stockholders' rights and I have made some of those same arguments.

I have also seen the aftereffect in the last couple of years in several companies, some of which you have been involved with directly in my State—the Cities Service and Phillips acquisitions.

Just a question on Cities Service: now that Cities Service has been taken over by Occidental, do you think that our country—I understand that the stockholders may be better off, but do you think the country and the energy industry is better off for having Occidental and Cities Service merged?

Mr. PICKENS. I do not think they are any worse off.

Senator NICKLES. Well, with the fact that we have seen Cities Service somewhat divided and decimated, spun off in an effort to pay off the debt that was incurred?

Mr. PICKENS. Well, if you go back and look at the comparative records of Occidental and Cities Service, Occidental beats them ten to one. They have been better oil-finders; they have made better use of their capital.

Senator NICKLES. Occidental did not have any domestic production to speak of.

Mr. PICKENS. Well, they do now when they got Cities Service.

Senator NICKLES. Well, do you think it is better, though, now that Occidental has spun off the——

Mr. PICKENS. Well, I think Occidental without a doubt had better exploration people and could do a better job than Cities Service. If we are talking about finding oil and gas, I would bet on Occidental every time. So I do not see any loss for this country or the consumer on that point.

Senator NICKLES. Maybe a more recent example, then, with Phillips Petroleum, which again you were involved with—Phillips was successful in fending off your offer and then a later attempt.

I understand, and I also appreciate your statement where you basically said that your goal was to take over and to run these companies. So you were looking at an ongoing operation, although it might have been substantially smaller scale.

Mr. PICKENS. I am not so sure it would have been a smaller scale. It may have been a larger operation.

Senator NICKLES. Well, the net result, though—let us just look at the net result with Phillips, which is a large, integrated oil company. They were successful in fending off yourself, and also Mr. Icahn, but the net result is, as well, that they have incurred very large debts, several billion dollars, to be successful.

Do you think that Phillips Petroleum is now better suited as a company for the fact that they have incurred that large of a debt?

Mr. PICKENS. Well, I think for one thing you have totally ignored what happened to the stockholders.

Senator NICKLES. I understand that the stockholders are better off, and we have a lot of Oklahoma Phillips stockholders that did quite well.

Mr. PICKENS. Well, the stockholders at Phillips—their enhanced value was—let me just give you the number. The enhanced value for the stockholders was $2.79 billion.

Senator NICKLES. I understand that.

Mr. PICKENS. You know, the CEO has testified here at hearings that I have been on that he says the company is better off now; that they have done something for their stockholders. I think he is quoted in the New York Times saying just that, that it is a leaner company that will do a better job.

So I will just go with him. He is inside there looking at the numbers, and I know you believe Bill Douce to be an honest person. And I believe him to be an honest person and he says the company is better off.

As far as the debt is concerned, Phillips has a cash flow of about $2.5 billion. I think their debt is about $4.7 billion, and there will be no problem as far as their servicing that debt. It will amortize very nicely and the company will have a substantial budget.

I think that if I can recall Douce correctly, several weeks ago here before a House Ways and Means Committee hearing he said there that the budget would not be reduced. It would not be expanded, he said. I do not see anything wrong with that.

I think the company is sound and I think you will probably see a better managed company than you have in the past.

Senator NICKLES. To pay off, I believe, that $4 billion in debt, if they have to sell off substantial interest, whether it be North Sea or whether it be General American or whatever, do you think that still enhances their operations as an oil company and the energy industry as a whole?

Mr. PICKENS. Well, bear in mind if they sell something off, Senator Nickles, it is not going to disappear; it is going to go into somebody else's hands. So when you start talking about what it did to the industry, whether Phillips manages the properties or whether Exxon manages the properties or Shell Oil, somebody else is going to manage it.

I would assume those managements to be the equal of Phillips, so I see no loss there at all. The stockholders came out very well in the transaction, so I do not see where there is any problem here.

This goes on all the time in this industry, selling off and buying. Remember that Phillips made two acquisitions, one Aminol and one General American. The one we made the offer for, Phillips topped. So I mean they have made acquisitions.

Senator NICKLES. I have often thought this country would have been a lot better off if you had been successful with General American and we would not have seen quite so many dominoes fall.

Mr. PICKENS. Well, I do not know whether the country would be better off. I know the stockholders would and I know the Federal tax revenues would be better off had that been the case.

But had we acquired Cities Service in 1982, we would have moved to Tulsa and run the company from there. One point that I would like to make——

Senator NICKLES. I am sure that right now, Fred Hartley with Unocal and probably Bill Douce with Phillips and probably Mr. Lee with Gulf sure wish that you would have been successful with Cities Service.

Mr. PICKENS. Well, I hear from friends that Mr. Lee is very happy, retired in Mississippi with $10 million.

Senator NICKLES. I do not doubt that he is.

Mr. PICKENS. I mean, Mr. Lee is doing what I would like to do sometime, hunt quail when I want to and play golf when I want to. One point I would like to make: we only have 650 employees and you were looking at Cities Service with 16,000 employees.

There is no way in the world we have any job overlap with not over half a dozen people. I run an operation that I mean is lean and we just do not have people sitting around, any warm bodies.

So when we make a deal for one of these companies, and I hope that we make the deal for Unocal, there is not going to be any job overlap in the deal.

Senator NICKLES. You mentioned Cities Service had 16,000 employees. I can tell you they have fewer employees now as a direct result of your attempt, and that is what bothers me. We lost over 300 jobs in Oklahoma alone. Again, I wrestled with this. We have got a lot of legislative solutions.

You told Senator Simon that you would support some legislation to prohibit greenmail. I am not sure which of the legislative remedies are right. But, Mr. Chairman, just to somewhat summarize my comment, I have opposed, and I expect I would still oppose, some of the legislative remedies.

But I do appreciate the fact that you are holding this hearing and looking at them and I would hope that maybe between the Judiciary Committee, the Finance Committee, the Energy Committee, and others, we would look at the various proposed changes and see if there are any that would be constructive. I am also concerned that acquisition debt might make oil companies cut back on exploration.

I will just summarize and say that when I see that Continental is now forced into Du Pont, and Du Pont had to incur substantial debt to do so, when I see Cities forced into Occidental or looking for Occidental as a white knight—incurred substantial debt to do so and had to spin off substantial reserves to do so—when I look at Gulf running to Chevron as a white knight and the amount of debt that is involved there; the Texaco-Getty deal which has also involved thousands of employees in my State—when I see Phillips Petroleum incurring billions of dollars in debt—and I personally think that maybe this is not the best time for energy companies to be taking on additional debt and having to spin off reserves when oil prices are really very low.

When I see a restructuring of Arco, and I really have not looked at that substantially, but I really am concerned. I see a lot of medium-sized companies that are being forced into some very large companies. I see a lot of junk bond financing.

Mr. Pickens stated that his financing had a lot of solid collateral behind it, but I question sometimes when all of a sudden I see new financiers appearing on the scene, with Wall Street financiers coming up with billions of dollars, some of which, or maybe a sub-

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stantial portion of which is very short-term, extremely high-yield, and my guess would be very little collateral behind it as well.

So whether or not we are talking about the nondeductibility on interest, whether we are talking about taxes on greenmail, whether we are talking about some type of prohibition or limitations on junk bonds or some changes in securities laws, I am not sure.

But, again, I appreciate your interest, and also I appreciate the witnesses that you have appearing before you today.

Mr. PICKENS. May I make one comment for the record? You will remember Cities Service made the offer for us first. We did not tender for Cities Service; they came after us first. We made a countertender offer.

Senator NICKLES. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

The distinguished Senator from Ohio.

Senator METZENBAUM. Mr. Pickens, you have done something for this country. Some people perceive you as a rampaging buckaneer attempting to take over lots of companies. You like to perceive yourself in a white hat, protecting the shareholders.

But whatever is the right perception, you have done more than any single person in radicalizing some of my colleagues in the U.S. Senate. [Laughter.]

I never thought I would hear Don Nickles and Dave Boren and Bennett Johnston supporting antimerger legislation because in the past they have been on the opposite side. So I think that you have driven them into a very radical position, but somehow I have the feeling that they will survive in spite of that.

I find your operations interesting and I think they are innovative, and I think that as far as I can see, they are within the laws of the country. I am not at all certain that the laws should not be changed. But along that line I will say this: if there is to be a moratorium, I very strongly feel that during the moratorium the poison pills and the greenmail and the shark repellants and the golden parachutes and all of the others—there would also have to be a moratorium on those as well.

I think some would just like to protect entrenched management and some would want to do nothing. I think that maybe Congress ought to do something and I hope that within a short period of time we will be able to decide what to do. But I do not find fault in the American free enterprise system with what you are doing. You are doing it for the same reason so many other people do what they do, and that is to make a profit, and you have got a legal right to do that, and a legitimate right.

Now, if a company found itself with undervalued stocks, one way of helping its shareholders, and you have suggested this in some instances, would be to spin off some of its subsidiaries directly to the shareholders.

Where you find that a company has a liquidation value substantially in excess of its market value, do you generally think that the corporate officers ought to move in that direction?

Mr. PICKENS. Is that my question?

Senator METZENBAUM. Yes.

Mr. PICKENS. Do I think that—I am sorry.

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Senator METZENBAUM. I am sorry if I did not make it clear. What I am saying is that very often, a company—separate parts are worth substantially in excess of the market value, and I ask you this in view of the fact that this administration has sort of taken a position that bigger is better and they have not been inclined to stop the mergers of some of the largest corporations in America.

What I am asking you is when the liquidation value is greater by spinning off the subs, do you think, generally speaking, that that is a good step for the corporate officers to take?

Mr. PICKENS. Well, I think it is something that should be considered. I think corporate officers—and 5 years ago in a speech that I made, I said that some of these companies are so fat that the officers of the company do not even know their own assets.

I think you should know them; I think you should know what your assets are doing and what the return is on them. And in some cases companies—I saw the one on 60 Minutes the other day, and you may have seen it, the fellow that formed Mr. Gasket. He sold Mr. Gasket to, I believe, W.R. Grace and he sold it for $17 million and the fellow was in his midthirties.

He was a true free enterpriser. He started himself, worked in the shop, did the job, sold the company out for $17 million and retired at 35 years old, and 4 years later bought the company back from W.R. Grace for $4 million because they could not make it go because they did not have that entrepreneurial spirit and the drive that this fellow had. And then he took the company public a year later, I believe, for $150 million.

Now, to me, that is real entrepreneurship and I do not think that W.R. Grace knew what those assets were worth, or they did not have the people to be able to direct the assets around to get the kind of return that they wanted.

I think there are a lot of companies that have these things buried in them. I think that if we could invigorate the managements in corporate America to do with those assets what they have been entrusted to do and what they are paid to do with them—make them go, make them work.

We have seen companies—go back and look at the Milwaukee Railroad deal. It went into bankruptcy. Leon Levy and Lester Pollack and Jack Nash all took that company and worked it around now, and I remember when the stock was $35 a share; it is now $200 a share. A story was in Forbes Magazine about 2 months ago on that one.

But those are the kinds of things that we need to shake these people up; we need to get them back at their desk. We need them to do the things that they have been paid to do. So, yes, I think in some cases it is better to be smaller.

To me, the whole thing comes down to about three or four points. One, stockholders own companies. Two, stockholders should be allowed to see any offer that comes to them, no different than if you owned your house; you would not have anybody standing in the way telling you it is not in your best interest to sell the house. So they have a chance to take the deal or turn the deal down.

At the same time, I think that managements need to understand that they are going to have to perform for the owners. We have gotten it around to a point where managements believe they own

companies, and consequently it all comes down to I believe today that we are at a crossroads in corporate America.

That crossroads is we are going to establish who owns the company, whether it is the managements or whether it is the stockholders of the company. And if we establish that the stockholders do own the company, then we are going to also establish that managements, just like me, work for the stockholders; we are employees is what we are and we are paid to do a job.

Senator METZENBAUM. Do you think that the Congress ought to give its attention to the rights of stockholders to nominate and then elect directors or to participate in annual meetings?

Mr. PICKENS. Mr. Metzenbaum, you and I both know—and I know something of your background; you came up through business and all.

Senator METZENBAUM. That is true, and the man you mentioned before, Joe Hrudka, is a very close friend of mine, I might say, and a very able individual.

Mr. PICKENS. Joe——

Senator METZENBAUM. The fellow that did Mr. Gasket is a Clevelander.

Mr. PICKENS. OK. You know who I am talking about?

Senator METZENBAUM. Very well, very well.

Mr. PICKENS. I mean, a fantastic story.

Senator METZENBAUM. It certainly is.

Mr. PICKENS. I did not remember his name.

Senator METZENBAUM. H-r-u-d-k-a. As a matter of fact, he is true Americana; he is a fellow who came up the hard way through the shops and he has truly done a magnificent job.

Mr. PICKENS. He showed a personality trait which I thought was unusual, and that was that he had the patience to sit back and wait until that business came back to him again. I thought that was unusual. You do not see entrepreneurs having that kind of patience; they usually are back at something else right quick.

Where were we, at what point?

Senator METZENBAUM. The question of whether stockholders ought to have a right to be involved as far as electing corporate directors. Let me give you an example. This is not a corporation in the sense of being the typical kind; it is a mutual.

Metropolitan Life Insurance Co. is a mutual life insurance company. In order to nominate a director, I think you have to get something like 1 percent of the policyholders to join in the nominating petition and I think that takes something like 32,000 names.

In a hearing I held some years ago, an individual appeared and he made an effort to do that. But in order to do it, he needed the stockholders list.

Mr. PICKENS. They would not give it to him.

Senator METZENBAUM. They would not give it to him and they gave him some fantastic figures of what it would cost to do it and then Mr. Shin, I think his name is, head of Metropolitan Life Insurance Company, came before our committee and said the policyholders do not own the company.

And I said, well, if it is mutual company and the policyholders do not own it, then who does own it? But that is the furthest because if it is a mutual company and the policyholders do not own it, then

certainly it is a lesser degree where they are shareholders in a corporation.

But you mention, and I agree with you, that corporate management thinks they own the company and are not willing to share information or the right to nominate directors or any involvement in proposing something at an annual meeting. As a consequence, it seems to me it is a blot on the whole free enterprise system when you tell the shareholders you do not have any rights at all in this company.

Mr. PICKENS. I agree with you a hundred percent, and the fact that they could not reproduce a stockholder list or a policyholder list is ridiculous; they sure can. But those are the things I am opposed to; I do not like that.

I think that, again, I am back to stockholders do own the company and they are entitled to be heard from, but this thing has all been separated. I think it came after World War II and what happened is it has gotten worse and worse and the separations become greater and greater.

The stockholder sits there and looks at the high, low, and close on the New York Stock Exchange and the management of the company is over here with full control of the assets and has practically no ownership and no risk in the deal. I just cannot believe it.

And you ask them something as a stockholder and they file a lawsuit against you; it is incredible. We have got Unocal now; we are their largest stockholder and you cannot believe it. I mean, the chairman of Unocal has called me an idiot; he has said I have no morals.

I tried to shake hands with him up here the other day and he said, you do not deserve to shake my hand. We are his largest stockholder; I mean, he is an employee of ours. He takes the money of the stockholders, ours, and sues me. I mean, it is incredible what is going on.

He then says we are going to offer $72 a share for 50 million shares, but you are not going to get in on it, and we just won that suit in Delaware on Monday of this week. It is incredible. When is it going to be that he is not going to let somebody from Ohio tender their shares, or Georgia, or somebody that is in some other business or somebody that kept him out of a country club somewhere?

It is insane to believe that you are going to differentiate between stockholders, regardless of the day they bought the stock. Somebody says, well, you have not owned it as long as I have. It does not say anything like that on the stock certificate. My certificate is just like yours is.

Senator METZENBAUM. As you know, the requirement with respect to tender offer today is 20 days. Do you agree that that minimum waiting period should be extended to something beyond that so that the shareholders might have an opportunity to actually make an evaluation and know what it is all about?

Mr. PICKENS. Well, you have got to watch out for this one, that you are not entrenching the management.

Senator METZENBAUM. I understand that.

Mr. PICKENS. That is the fear of that. Now, in our case we are asking for a 2-month moratorium on the stockholders meeting and

we have got the other side saying no, we want to handle it right now.

It is interesting. They do not want any delay and we are out there fighting in a proxy fight right now. We got it delayed by the Federal judge in California for 2 weeks and now we are going to have to go back to bat on May 13 to try to get it extended 2 months.

The 20 days, I think, has to be looked at closely, Mr. Metzenbaum. Be sure that you are not giving management a break and hurting the stockholders. Generally, stockholders can read a premium to market offer very quickly.

Senator METZENBAUM. In the bill that we are introducing, we would extend the time, but we would prohibit any corporate action along this line unless there were shareholder approval. Shareholder approval cannot occur within a week or 10 days; I mean, that takes some time itself.

In other words, you could not put in a poison pill arrangement or a shark repellant or something of that kind. And under those circumstances, would you have any difficulty with extending the time?

Mr. PICKENS. Well, do not make me answer sitting right here on that question. I would like to see what it looks like in the full——

Senator METZENBAUM. We are interested in trying to find a piece of legislation that has balance to it.

Mr. PICKENS. Well, I want you to do anything you can for stockholders because they have been battered around all they can stand, and if we do not watch out, you are going to get all these entrenchment devices put in place and then what will happen is the investing public will lose interest in these equities.

Consequently, you are going to see a reaction as to what these equities are worth because they are going to get these managements in a position where they never have to answer to stockholders.

Senator METZENBAUM. We would be very happy to discuss the subject with you. We know you have some priorities at the moment, but we want to move rather rapidly on this. If you have the time, we would be happy to share our views and pick your brains as to your views.

Mr. PICKENS. Thank you. I would like to get with you on it.

Senator METZENBAUM. Very good.

Management uses poison pills, sale of crown jewels, and various and sundry other procedures during a takeover effort. Do you feel that those actions might be more justified if there were shareholder approval?

Mr. PICKENS. Well, there is not any way in the world the shareholders would ever go for a poison pill. I mean, that is absolutely arbitrarily taking the rights away from stockholders. So I would say, you know, if you are going to put a poison pill in, the stockholders sure ought to have an opportunity to turn it down, and they will.

To me, poison pills are about to be a thing of the past because there has been so much publicity on them. I think managements are getting frightened about putting those things in.

Now, we have got one out at Unocal right now. They have got a poison pill on us, but if given a little bit of time, this system will straighten itself out on these kinds of moves by managements.

Senator METZENBAUM. You have got poison pills and selling of the crown jewels.

Mr. PICKENS. You have got to watch out talking about selling of the crown jewels because I do not think that the United States wants to get into a situation where you are deciding whether somebody should sell something or hold it. I think you have got to watch out on that one; that is going to be very complicated.

Senator METZENBAUM. Well, I do not think we would want to get into it except in those instances in which that step might be taken merely as a defensive tactic to a hostile takeover.

Mr. PICKENS. Well, I mean who decides it is a defensive tactic, and then you could be hung up in a deal where the stockholders are going to be damaged in that. I think those kinds of things need to be looked at very closely.

Senator METZENBAUM. In your own company, is a stockholder list available to any stockholder?

Mr. PICKENS. Yes. They will have to pay for the reproduction cost.

Senator METZENBAUM. Which is modest, I would assume.

Mr. PICKENS. Yes; I mean, just whatever it takes to run it through the machine.

Senator METZENBAUM. Yes. According to Business Week, Mesa posted a 34.2-percent return on equity in 1984, but paid out yield at only a 7-percent return to the shareholders in the last three years.

Business Week also said you were the CEO who produced the lowest profits in shareholder gain for your pay. Would you care to——

Mr. PICKENS. Sure, I will be glad to respond to it. In fact, if you can believe it, Business Week had me as their keynote speaker yesterday at one of their conferences after they wrote that the week before.

Senator METZENBAUM. Well, I find that people sometimes have you as a speaker notwithstanding the fact that they do not agree with your point of view. [Laughter.]

Mr. PICKENS. Well, I could have sure gotten a sore throat easy yesterday at the last minute if I had wanted to do that, but let me comment in this way. When they said the poorest return to stockholders—we are not a dividend-paying company. I will speak to that point first.

In 1979, we spun off half of our gas reserves to the stockholders, which were worth about $500 million. Also, in 1982, we spun off another trust to our stockholders, which at that time was worth about $150 million. So, periodically, we have certainly taken care of the stockholders.

Most of all, we sell at 100 percent of appraised value, and therein is the reason why nobody ever makes an offer for Mesa Petroleum is because we are selling at 100 percent of appraised value.

If you take the ten largest oil companies in the United States, they sell at 45 percent of appraised value, and if, just if, those companies——

Senator METZENBAUM. What percent?

Mr. PICKENS. Forty-five percent of appraised value.

If those companies could raise their market price to 75 percent of appraised value—now, we are selling at 100. If they could raise theirs to 75, 4 million stockholders in corporate America would make $80 billion. Can you imagine how much you would pick up in taxes out of that? It would be tremendous.

So we are selling at 100 percent of appraised value. The period that they say I did least for my stockholders and paid the most—they took it over the period 1982, 1983 and 1984, which were really tough years for the oil industry.

If they would have taken it over the period that I was—by the way, that is a deferred compensation is what it is; I have not received that money. But if they took it over——

Senator METZENBAUM. You did not receive——

Mr. PICKENS. No, sir. I did not receive—that is a deferred compensation pool.

Senator METZENBAUM. Well, they said that you received $22 million.

Mr. PICKENS. That is right. I did not receive $22 million. I got $3 million at the end of, I believe, 1983, and then over 1984—that was for money that we had made that could be directly attributed to my efforts. But in 1984, that was a $20 million deferred compensation pool; my part of it is $18 million, but I get that over an extended period of time.

They did not point that out either, but I want to be sure and get this in, that they said I did the poorest job for my stockholders. They took it over 1982, 1983 and 1984, which were really tough years for the oil industry.

They gave me that deferred compensation for my performance in 1984 is what it was, and in 1984 we increased reserves of oil and gas at Mesa by 50 percent. You said we had a return on equity there of 36 percent?

Senator METZENBAUM. Business Week had a 34.2-percent return on equity in 1984.

Mr. PICKENS. A 34.2-percent return on equity in 1984; 50 percent, we increased our reserves, and our stock price went up over that 12-month period by 36 percent. That was never mentioned in the article, which I pointed out to them yesterday at the conference, and I got no arguments from anybody.

Senator METZENBAUM. Would you support the concept of uniform listing standards for the New York Stock Exchange, Amex and ASD to require one share, one vote, rather than dual capitalization plans?

Mr. PICKENS. Absolutely, one share, one vote; that is exactly the way it should be.

Senator METZENBAUM. I do not know if you are aware of this or not, but I have introduced legislation to close the so-called 10-day window where potential buyers can acquire large holdings in a target firm for 10 days before disclosing the fact.

Should not shareholders be entitled to that information as soon as possible; in other words, substantially less than the 10 days?

Mr. PICKENS. The problem there is that you will shut down the acquiror in that; you will cause deals not to be made. Now, I know

what your concern is. I mean, your concern is that they know what is going to happen and nobody else does.

Senator METZENBAUM. That is right.

Mr. PICKENS. But they never get the position to be able to—as you well know, they are putting money at risk in here. I mean, you can see this Unocal deal. We have got $1.1 billion in this particular deal and it is terribly expensive, one, carrying the investment, and two is the fact that you are constantly harassed by litigation to keep your offer away from the stockholders.

So what will happen to you if you do that is you will stop companies from—they will try to figure out how they can get the ownership some other way. I do not know how they would do it, but if you do just a straightaway offer at a target and you have no ownership in it, then if you are unsuccessful you cannot even cover your cost.

Senator METZENBAUM. Well, let me ask you this: let us assume that on day one you or your someone else buys 10 percent, gets a 10 percent position, or whatever, 15 percent. It is very difficult to keep a secret, particularly with the investment bankers. They learn that you had to get the money and it is very difficult to keep things quiet.

If you have a 10-day window before you have to disclose, it seems to me that the small shareholder who is out all over the country—he or she does not know about it, but the smart boys in Wall Street or around the country who are in the financial markets get wind that Boone Pickens is moving in, or whosoever else.

I can understand that when you are acquiring, your point is, well, if you start in this period, this is an acquisition period. But let us assume it is not an acquisition period. You have made your acquisition, you have stopped buying for the moment. You do not have to give notification for 10 days.

The stock makes a run; the small shareholder gets left at the wayside because he or she sells out, and that is the reason some of us think that the 10-day window is not fair to the small shareholder.

Mr. PICKENS. Well, of course, the 10-day window—I do not identify it as a window, but it is the running time after you go through the 5 percent for the 13(d) filing.

Senator METZENBAUM. Right.

Mr. PICKENS. So you have had 5 percent up at that point and then you have 10 days to run to build a position. What does the SEC study show as to how much of the stock is actually coming out of this small stockholder's holdings?

Now, it would be my feeling, and this is merely an assumption on my part, that they are pretty slow to react. They are not sitting there watching that market that closely and they are not responding to a two-point increase or something like that.

The ones that I think you will find are selling into that 10-day period are the institutions, and the reason they are selling into it is that they have got a profit and they are reducing position.

I think some of them have a signal to sell; like, for instance, if it moved up two points, they would sell 25 percent of their position. If it moved up five points, they may sell a half and then hold to see if there is going to be something else happening.

So I think most of that volume is coming out of institutions.

Senator METZENBAUM. When you make your acquisitions of a position, do you normally do it by going through the trader at the New York Stock Exchange?

Mr. PICKENS. Going through what?

Senator METZENBAUM. The trader. In other words, do you do it through the exchange or do you find places where there are blocks of stock and say we would be willing to take your position out for *x* dollars or *y* dollars?

My question is if you are just going through the brokerage firm or the investment banking firm and you are going through the New York Stock Exchange, then that is one thing. If, on the other hand, you are making your acquisition from Prudential and Prudential is running it through the New York Stock Exchange because I think they have to, as a matter of fact, that is a different kind of a trade.

I just am curious as to how you go about acquiring positions when you do just that.

Mr. PICKENS. We do not call any blocks and ask them if they would like to sell some or all of their block. We do go through—and I will be glad to sit with you and explain to you the details of this. I do not think you want to hear them here, but we do have an elaborate process to be confidential about what we are doing and I would just as soon not speli that out to some of my competitors.

Senator METZENBAUM. I would like to hear that.

Mr. PICKENS. You know, it is very straightforward in how we do it, but we do not call around to big blocks of stock and say, would you sell, the reason being that gives them an immediate tip as to what is going on because they say, oh, we can see through this; they are getting ready to go for somebody.

That is one that was used. I am not sure which one; it may have been Beck and Dickinson had a problem with that one time.

Senator METZENBAUM. I have one last question.

Mr. PICKENS. Yes.

Senator METZENBAUM. In many of these transactions, you take a position personally and Mesa takes a position personally, is that correct?

Mr. PICKENS. No, it is not.

Senator METZENBAUM. Not personally; I mean separately. No?

Mr. PICKENS. No, I do not take a position personally. Now, to clarify that point, on this deferred compensation that we received, the $20 million deferred compensation, that does go in and it does play side-by-side in deals on a proportionate basis with Mesa.

Senator METZENBAUM. But it is part of the corporate undertaking?

Mr. PICKENS. Yes. We have no discretion over it.

Senator METZENBAUM. Boone Pickens himself is not a buyer of stock?

Mr. PICKENS. Absolutely not. One thing that you should know is on that deferred compensation pool, in the event that Mesa was in a deal and trying to make an acquisition and came out a loser, that deferred compensation pool would suffer any losses proportionately the same as the stockholders would, so it could be lost.

Senator METZENBAUM. Thank you. I have no further questions, Mr. Chairman.

Senator MCCONNELL [presiding]. Thank you, Senator Metzenbaum. Thank you, Mr. Pickens.

Our next witness is the Honorable James Edwards, former Governor of South Carolina and Secretary of Energy.

Mr. PICKENS. You are telling me I am through?

Senator MCCONNELL. Yes, sir.

Mr. PICKENS. OK.

Senator MCCONNELL. I am sorry; I should have made that more clear. Thank you for coming.

Senator METZENBAUM. Mr. Chairman, no offense to Governor Edwards—I worked with him when he was here, but there is another committee having to do with energy, as a matter of fact, and as soon as I get back from that, I do have some questions. Thank you.

Senator MCCONNELL. I might also say that Governor Edwards had the good judgment to go to the University of Louisville—early signs of sagacity.

Governor, if you could give a 5-minute summary of your testimony, we would be happy to put the full text in the record.

## STATEMENT OF JAMES B. EDWARDS, DIRECTOR, PHILLIPS PETROLEUM CO., CHARLESTON, SC

Mr. EDWARDS. Thank you, Mr. Chairman. It is nice being here this morning. It is nice to be here when the heat is not on you quite as heavily as it was when I was appearing before some of these committees in my role as Secretary of Energy.

But I do want to express my appreciation to the chairman and to the members of the committee for holding these hearings on this very vital public issue. Senator, I am president of the Medical University of South Carolina now. I serve on six corporate boards; two of those have had hostile raider attempts recently and my written statement today is also in conjunction with my good friend, Mel Laird, former Congressman and former Secretary of Defense, who now today serves on eight corporate boards.

Between the two of us, we have witnessed six hostile takeover attempts. Mr. Laird wanted to be here with us today, but he had a previous commitment of long standing, several months' duration, to appear at the University of Wisconsin today at a youth leadership conference. He is out there with our Secretary of Transportation, Libby Dole, so he extended his regrets to the committee as not being able to be here.

Mr. McConnell, if I could submit my written testimony for the record, I would appreciate it.

Senator MCCONNELL. That will be done.

Mr. EDWARDS. I would like to say a few things about this whole situation. I am not an expert in economics. I said that several times while I was here in Washington and I did not even talk about economic issues for about a year. But after I had been here for about a year, I realized I knew about as much about economics as anybody here.

I think this situation is one that needs addressing, and I find myself in an awkward position because I have always been a

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staunch defender of the free enterprise system, the free market, if you would.

I am not against mergers as long as mergers take place in the usual and customary fashion where the raider entrepreneur, if you would, will go in and, with equity of his own, risk that equity and the equity of the potential company that he is taking over.

If it is for the purpose of expanding markets and increasing productivity in this country and basically creating more jobs, I think it is great to have mergers. But, Mr. McConnell and members of the committee, there are people who feel that these are not true mergers, these hostile takeovers, but they are financial transactions, and it is a transaction that takes really short-term profit over long-term performance, and it makes that decision up front to do that.

I have given a lot of thought as to why, all of a sudden, we have this problem in our free enterprise system. Why has it just come up? One reason is that—well, there are several reasons.

No. 1 is that the stocks are undervalued because there is no price built in for long-term research and development, long-term capital expenditures. It is the immediate profit that most stocks are based on, unfortunately.

The second thing is that during our strong inflationary period of the late seventies and eighties and the high-interest period, if you would, there was a movement out of the investment of the American people from equities in the stock market over to Government securities, where you could get 15, 16, and sometimes 17 percent return on your investment without any risk at all because you had the full faith and credit of the Federal Government behind you.

As a result of that, stock prices remained very, very low. But during this same period of time, well-managed companies produced for the company and they invested in long-term capital projects, did a lot of research and development, and became stronger companies because of it.

Then all of a sudden we have developed a new breed on Wall Street that has tremendous insight into the analytical capabilities to look at a company and say what its true worth really is.

These raider entrepreneurs win no matter how they do it. There is a no-lose situation here because a raider entrepreneur will look at a company and he will find one that is extremely underpriced as it relates to what its true value is, and the oil and gas companies of this great nation fortunately did what we urged them to do when I was Secretary of Energy. We urged them to go out and produce more oil and gas, find more energy sources, and they did.

Today, they are in double jeopardy because they have been successful in finding oil and gas reserves, and now we find that these reserves are there. The stock market has not recognized the value of these reserves, but some of these sharp entrepreneurial raiders have and they will go in and make their move.

Well, now, it is a no-lose proposition, Mr. McConnell, because if one of these well-known raiders goes in and starts making his move, he can buy 5 percent without anybody knowing it, except a few people on Wall Street, and then he has to fill out his 13(d), I believe it is, to say that he is buying more than 5 percent. Then he has 10 days to continue buying these shares.

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Then he makes his move—you know, the proxy fight and all that—and if he is successful, well, he wins because he can tear this company apart. For example, particularly oil companies—they find that these companies are worth more dead than alive, and that is a fact. Most of the oil companies today have been so successful at finding reserves, they are, in fact, worth more dead than alive.

So if they are successful in taking over the company, they throw the old managers out, they throw the board out, and replace it with their own board. Then they tear these companies apart, sell the parts, and come out with a nifty profit in their own pockets.

Of course, all the rest of the stockholders share in these profits, too, and there is no question about that. But what they are doing, Mr. McConnell, is they are trading long-term debt of the company for a profit that goes into their own pockets. They are loading these companies with long-term debt, making it very difficult for them to go out and do exploration and development.

All of their profits in the future, all of their cash flow, a great portion of it, is going to have to pay off this tremendous debt, Mr. Chairman. Now, if they fail to be successful and they do not gain control of these companies, they win anyway because they have got this large block.

For example, some of them are the largest shareholders some of these companies have and the very fact that they start making the move makes everybody pile on. All these arbitrageurs on Wall Street and across the country, they pile on and start betting with that raider entrepreneur. The price goes up. They are not successful, but they sell out at a higher price, so they win anyway.

So they are taking advantage of a situation that allows them to take advantage of our tax codes to do these things that, in my opinion, are very destructive to the markets. They finance them with junk bonds, and we will not go into the definition of junk bonds; you know what those are.

But they finance them with junk bonds, which are not as safe as some of the investments that we would like to make. But it has an effect upon our financial system in this country. If a lot of these companies are financed with junk bonds, then it is going to make our financial situation in this country very shaky in years to come if we do not disrupt it.

Now, Mr. Chairman, one other thing that I would like to mention, and that is the institutional investor. Twenty years ago in this country, most of the holders of stock were average citizens scattered throughout this country, holding a few shares.

Today, that is not the case. Today, 60 percent of all the equities in this country are held by large institutions, holding pension plans for municipalities, cities, counties across this Nation. They hold over $1 trillion in equities, 60 percent of all the stock held by large institutions, and about 75 percent of all the transactions on the stock market today are by these large institutions with these large holdings.

Now, Mr. McConnell, the loyalty of an institution varies greatly with the loyalty of these little stockholders spread across this country. In the Phillips situation, for example, we had 80 percent of all the stockholders that held less than 5,000 shares.

But the loyalty of these institutions that hold these tremendous holdings—and 44 percent, I believe, of Phillips stock was held by these institutions—their loyalty runs to about an eighth of a point.

The laws of this country dictate that under the—what do they call it, the prudent man situation—the prudent man that controls these stocks must act prudently and take advantage of any situation that comes along or they will be in trouble with the law.

So, Mr. Chairman, I think the fact that these institutions now have corraled so many holdings, so much of our stock, it makes it much easier for a raider entrepreneur to gather up these large shares and make their move successfully to take over companies.

Mr. McConnell, I think that summarizes where we are and why we are here, and I hate to appear before a committee like this without any recommendations. So I would like to make some recommendations, if you would.

I think Senator Nickles' and Senator Boren's moratorium bill is certainly a bill that deserves consideration. It gives that company time to examine itself and decide what it would like to do and what would be in the best interests of the stockholders, really.

The second thing—I think the Hart-Scott-Rodino amendments should certainly be looked at very closely, and I think I notice on the schedule my good friend, Jim Miller, is going to appear today. You might question Mr. Miller about the enforcement, the need for stronger enforcement of these Hart-Scott-Rodino amendments.

As you know, it provides time for antitrust review by the FTC and the Department of Justice on all acquisitions of any economic significance—all acquisitions and mergers.

The third thing I would recommend is that we modify the tax code. Today, the tax code provides an advantage to these entrepreneur raiders. They are using the tax code to finance these mergers, these hostile takeovers, with these junk bonds. So I would recommend that they tax greenmail at 50 percent—the profits from greenmail at 50 percent; modify the tax codes to do that.

I would recommend that we deny interest deductions on junk bonds when they are used to finance a hostile takeover. I think this would certainly slow down some of the activities.

Mr. Chairman, I would like to recommend that we look at the British system. Now, I was pleased that Mr. Pickens a few minutes ago—he said an offer to one stockholder should be made to all stockholders; any offer to one stockholder should be made to all stockholders. He said the courts had agreed with him on that point and I think that is very good.

But under the British system, if we could adopt that, it would solve most of our problems. I would like to leave a written summary of the British system here for the record. But, basically, in Britain you can acquire 10 percent of a company's stock. Then you have to announce that you have acquired it.

Then you can acquire 10 percent more, but there is a slowing in your ability to acquire over a certain period of time. But when you finally acquire 30 percent of a company's stock, from that point on, Mr. Chairman, you have to pay the holders, all shareholders alike, at the same time, and you have to pay them the highest price paid by the raider at any time in the previous 12 months.

Mr. Chairman, I think that would solve a great number of our problems. It would allow the market system to work. It would not obstruct true mergers where it is in the best interest of the economic system to have a merger. It would slow down these hostile mergers, which I like to refer to, as my friend—in fact, I would like to read, Mr. Chairman, in my closing statement a little statement by Marty Lipton, who is a partner in the law firm of Wachtell, Lipton, Rosen & Katz, and he is a leading authority on corporate takeovers and was our legal counsel with Phillips.

But he wrote recently an article; I believe it appeared in the Wall Street Journal, Mr. Chairman, and I would like to quote from that. He says:

> These takeovers are not for the purpose of diversification, expansion or growth, but they are financial transactions for the profit of the takeover entrepreneurs.
>
> They do not add to the national wealth. They merely rearrange ownership interests by substituting lenders for shareholders and shift risk from equity owners to creditors. They place our banking system and credit markets in jeopardy and restrict the ability of the affected businesses to grow and provide increased productivity and employment.
>
> They do not move assets into more efficient management. They move assets into hands that profit by reducing expenditures for research and development and capital improvements.
>
> After a highly leveraged takeover, a very high percentage of the revenues produced by the acquired assets are diverted to pay the debt incurred to acquire the assets.

There are a couple of paragraphs here, Mr. Chairman, I would like to leave out, but will wind up. He says:

> We have entered the era of two-tiered, front-end-loaded, bootstrap, bust-up, junk bond takeovers. Day after day, the takeover entrepreneurs are maximizing their returns at the expense of future generations that will not benefit from the research and development and capital investments that takeover entrepreneurs are forcing businesses to forgo.

Mr. Chairman, that ends the quote and I think that this is a very important public issue. Now that Senator Thurmond has come back, I want to publicly thank him for holding these hearings. I think a lot more has to be learned.

Once again, I am a strong defender of the free enterprise system and I am one who has never believed in Government interference in anything. But this is a flaw in the system, a defect, if you would, a loophole, a situation that has developed because of events of history and I think something must be done to close it.

Thank you, Mr. Chairman. I would be glad to respond to any questions anyone may have.

The CHAIRMAN. Governor Edwards, we want to welcome you here and we feel honored to have such a distinguished witness appear here. I just have a few questions.

Do you believe that the threat of takeovers distracts corporate managements from long-term competitive planning, thereby reducing competition?

Mr. EDWARDS. Mr. Chairman, I think that there is no question about it. It certainly does not improve competition. Anytime that you have as many companies being taken out of the industry—and I am just talking about, for example, the oil industry; let us restrict our remarks to the oil industry.

Anytime you have that reduction in competition of the number of companies that have been taken out by takeovers and mergers,

certainly this reduces competition. It also decreases the productivity of these companies because they have to take almost 100 percent of the management's time to fend off these hostile attempts.

They have to rearrange and restructure the company's finances. For example, Phillips Petroleum will not be the company it has been so far as exploration goes. In 1984, for example, our exploration budget is going to be reduced by about 20 percent, and this is in the face of tremendous successes in 1983.

For example, we increased our reserves by 130 percent, and it will take a while for that decreased budget in exploration to take effect. But, certainly, in the long run it is going to decrease not only competition, but this country's national security, Senator.

The CHAIRMAN. Governor Edwards, are there any ways in which the possibility of takeovers fosters competition and benefits shareholders?

Mr. EDWARDS. Senator, you know, when you talk about benefit to shareholders, nobody can deny that when you have a hostile takeover such as the one that we have just been through in a couple of companies that I have been associated with, in monetary value—immediate, short range value—the stockholders are helped along with the takeover entrepreneurial raider. He or she is helped tremendously.

For the short term, the shareholders certainly are helped monetarily. But in the long run, I think that the shareholders are harmed in the long run.

The CHAIRMAN. What was the experience of the stock value of Phillips Petroleum during and after the time that Phillips was the target of takeover activity?

Mr. EDWARDS. Senator, anytime a company—and Phillips has been no exception—anytime a company has a raider come in, particularly raiders of the reputation that some of our takeover entrepreneurs had that came into our company, the stock price went up.

But they have done an in-depth analysis of these companies, Senator, before they have made their move. Like I told the committee when you were out, you know, these companies have gone out and tried to solve the Nation's energy problem at our urging and they have produced tremendous reserves.

Finally, they have gotten to the point where they are worth more dead than alive. In other words, their true value far exceeds the price that they are selling for on the New York Stock Exchange. These raiders have tremendously capable analysts that go in and decide which companies to go for.

They realize that the value is low, but when they make their move, they realize also what the value of that company is that they can buy it for and then break it up and sell the parts and come out.

Most of them, I think—and not being one of them, I do not know what their thought processes are, but I think most of them are grateful when they are not successful because they make their money on the greenmail and the run-up of the stock and then they take their profit and get out. So I think the stockholders certainly are—you know, there are two sides to that.

The CHAIRMAN. Governor Edwards, do you believe that current antitrust procedures and analysis are sufficient to deal with any

potential adverse effects on competition caused by hostile takeovers?

Mr. EDWARDS. Mr. Chairman, as I said in my testimony, I think that the Hart-Scott-Rodino amendments should certainly be looked at and see if we have been enforcing them adequately. In my opinion, we have not been. I think there should be more emphasis on that.

The CHAIRMAN. I think that is all the questions I have. Thank you, Mr. Chairman.

Mr. EDWARDS. My friend, Jim Miller, is going to appear, I understand, as a witness this morning, so you might ask him. This committee might hold some hearings to see truly if that could address that issue and see if they are being enforced adequately.

[Prepared statement follows:]

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TESTIMONY

OF

JAMES B. EDWARDS

PRESIDENT, MEDICAL UNIVERSITY OF SOUTH CAROLINA

AND

MELVIN R. LAIRD

SENIOR COUNSELLOR FOR NATIONAL AND INTERNATIONAL AFFAIRS

FOR

READER'S DIGEST ASSOCIATION, INC.

Thank you Mr. Chairman. It is a pleasure to be here this morning. I applaud the committee for scheduling this hearing to review the very significant public policy issues that exist today because of the recent increases in hostile corporate takeover attempts. Mr. Chairman, I am James B. Edwards, President of the Medical University of South Carolina and an independent outside director of 6 major corporations: One of these companies, Phillips Petroleum Company, has been the subject of two recent hostile corporate takeover attempts over the last four months. Today I am appearing as an independent board member. My statement also reflects the views of the Honorable Melvin R. Laird, a forme member of Congress and Secretary of Defense, who is also an outside independent board member of 8 corporations and serves with me on the Phillips Board. Between the two of us, we have witnessed five hostile takeover attempts. Mr. Laird had hoped to be here with me today, but he agreed several months ago to appear at the University of Wisconsin with Secretary of Transportation, Elizabeth Dole. They are both appearing at a youth leadership conference and he was unable to break that commitment.

Over the last couple of months there has been a wealth of information provided to various committees of Congress concerning the pros and cons of corporate mergers, particularly hostile corporate takeovers. Before I go any further, Mr. Chairman, let me say that no one is a greater

defender of the free enterprise system than I. I have spent my whole career in support of the American economy and the free market that has made it great. However, I believe that there are specific reasons why the federal government needs to be concerned about the problem of hostile corporate takeovers. The conclusions that I have reached are based upon my experiences directly with companies involved in the thick of a hostile corporate takeover, as well as my experiences in and out of public life including, as you know, Mr. Chairman, having the privilege of serving as Governor of the State of South Carolina and as Secretary of the U.S. Department of Energy. I have not arrived at my recommendations lightly for I believe that basically, federal intervention in the marketplace should be avoided. However, the events that are occurring in corporate America are producing serious negative side effects to our economy and our society. In a nutshell, Mr. Chairman, I believe the problem can be characterized in one phrase -- and that is: The emphasis upon short-term profit over long-term performance. When we look at hostile corporate takeovers in this light, we begin to understand the concern.

Mergers and acquisitions among companies who are seeking to expand into new markets, grow existing product lines, or diversify into new businesses are legitimate transactions of the free market. I support the ability for the marketplace to reallocate resources in this fashion, consistent with our society's goals of fair competition, shareholder equity, and the production of jobs and products for employees, communities, and customers. There is very little argument that I am aware of that provides credible support for government interference to further restrict routine business combinations that will foster these goals.

This is an important point, Mr. Chairman, because the corporate raider will tell you the same thing -- that mergers and acquisitions are in the shareholder's interest. Mergers often maximize shareholder return, create wealth, and even

increase federal revenues. They will tell you that business mergers transfer assets into more productive uses and to more efficient managers. And this is generally all true, Mr. Chairman, when you're talking about soundly financed acquisitions that will redeploy the target company's assets for continued use. What the corporate raiders won't go to the trouble to tell you is that they aren't interested in the continued operation of the target company. They also won't make clear that their real objective is control of those assets for the main purpose of a quick sale and a quick profit that will leave the target -- which before the raid was a profitable, successful company -- completely liquidated or so burdened with debt that any attention to long-term performance is out of the question.

Now 15 or 20 years ago -- even 10 years ago -- there weren't these kinds of takeover attempts. When corporations sought out acquisitions -- they had to have a strong enough balance sheet to support a credible financing package for the target company. Lending institutions were conservative -- they didn't have a track record of loaning out huge sums of money without adequate security. If a lender was going to commit $100 million to an acquisition -- friendly or unfriendly -- he was first going to be sure that his client could cover the loan with his own assets. In other words, the acquiror was in the hunt because his judgment of the business gave him confidence that the target company's assets would be a strategic fit with his own business, offering value either in expansion or diversification. And he was prepared to risk a sufficient amount of his own equity on the move.

Otherwise he wouldn't be looking to buy, and lenders would not loan him the money to buy if he wasn't able to secure the loan. This situation, then, by its nature, produced acquisition attempts by strong companies to purchase weaker companies, and generally, larger companies seeking smaller companies.

Recently, the relatively new phenomenon of the highly leveraged hostile takeover attempt has emerged in the marketplace. I'm sure, Mr. Chairman, that you and the other committee members are familiar with the basic characteristics of this type of acquisition attempt. Innovative professionals in the financial industry, led by the Wall Street firm of Drexel Burnham Lambert, Inc., have developed a method of utilizing the low-grade, high-risk, high-yield debt market -- which has been around for a long time and has served as a valuable financial source for many firms -- as a tool for a corporate raider to prowl the marketplace, identify sound, profitable companies with under-valued assets, and make a move to acquire these assets without putting up the normal security once required. The catch is that, if the raider pulls off the deal -- and he uses provisions of the tax code and securities laws and regulations to his advantage to give him a leg up on management -- his prize will be so burdened by the high-risk debt -- known as junk bonds -- that he will liquidate the assets of the newly acquired company to pay off his creditors.

In effect, Mr. Chairman, to the corporate raider, the company is worth more dead than alive.

An article in the March 4, 1985, issue of Business Week, describes this process fairly well. It says, and I quote:

> "Drexel's 'leveraged' takeover works like this: The buyer sets up a new company on paper. Drexel creates a package of junk bonds to be issued by the paper company once it gains control through a tender offer. Then Milken (Drexel's head of its joint securities trading department) and his 125-person staff contact junk-bond investors, seeking advance commitments

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> to buy the bonds. Once in control, the raider can raise cash by selling off pieces of his new property. 'We take a minnow, identify a whale, then look to its assets to finance the transaction,' explains Michael D. Brown, Drexel's West Coast merger chief."

Thus, the minnow, having acquired the whale, cuts out its heart in order to finance the transactions. Notice that the targets today are strong companies with solid balance sheets -- not companies on the verge of bankruptcy. And their size is also no barrier to the raider.

Capital is thus no longer available for research and development or longer-term projects. The company's growth disappears; communities are de-stabilized and employees laid off; and suppliers and customers are disrupted. True, some shareholders may see short-term gain, but their long-term prospects for investment in the business are seriously diminished. As an independent outside Director, I believe that is not consistent with the interest of shareholders and the other constituents of a corporation to approve the liquidation of the business for what is, above all, a transfer of wealth from the equity base of the company to the corporate raider and his financial backers.

Mr. Martin Lipton, partner in the law firm of Wachtell, Lipton, Rosen & Katz, a leading authority on corporate takeovers and legal counsel to Phillips, recently made the following comment specifically about this practice that I believe clearly describes the problem:

> "These takeovers are not for the purpose of diversification, expansion or growth, but are financial transactions for the profit of the takeover entrepreneurs. They do not add to the national wealth. They merely rearrange ownership interests by substituting lenders for shareholders and shift risk from equity owners to creditors.

They place our banking system and credit markets in jeopardy and restrict the ability of the affected businesses to grow and provide increased productivity and employment. They do not move assets into more efficient management. They move assets into hands that profit by reducing expenditures for research and development and capital improvements. After a highly-leveraged takeover, a very high percentage of the revenues produced by the acquired assets are diverted to paying the debt incurred to acquire the assets. One can compare this situation to a farmer who does not rotate his crops, does not periodically let his land lie fallow, does not fertilize his land and does not protect his land by planting cover and creating wind breaks. In the early years, he will maximize his return from the land. It is a very profitable short-term use. But inevitably it leads to a dust bowl and economic disaster. We have entered the era of the two-tier, front-end loaded, boot-strap, bust-up, junk bond takeover. Day after day, the takeover entrepreneurs are maximizing their returns at the expense of future generations that will not benefit from the research and development and capital investments that takeover entrepreneurs are forcing business to forego."

Why have we seen the emergence of this activity?

One reason is that the shares of companies that reinvest substantial portions of their earnings into research and development and long-term capital projects are valued in the marketplace below their true worth. The stock market discounts future profits because of the diversion of earnings into these areas.

I also believe, Mr. Chairman, that we are witnessing today an undervaluation of stock prices, in part, because of the inflationary environment of the last fifteen years. Until

recently, high interest rates have allowed investors to cash out of equities and buy government securities, where they could receive a 15-16% return risk free. Equity ownership, therefore, was not as attractive. Management, in the meantime, continued to add value to their companies by reinvesting -- in capital and research and development. Asset values increased, while stock prices, proportionately, did not. Managements were in most cases doing the right thing to add value to their companies. Some managements may not have performed as effectively as possible and this too has been reflected in lower stock prices. But, Mr. Chairman, as I will describe shortly, the wave of hostile corporate takeover attempts is so far-reaching that I would not be surprised if only a handful of American companies are immune. I can't believe that the managements of all the other U.S. corporations have all been inefficient at enhancing shareholder value and hence totally responsible for the undervaluation of stock prices that is a necessity for the corporate raider to launch an attack. What we need to worry about, Mr. Chairman, is that today's managers will get the message that the hostile raiders are sending -- If you want to keep your company from being liquidated - emphasize the short-term gain and sacrifice future growth and profit.

Of course, I believe that it was then and is now essential for management to avoid this type of mentality and concentrate on thinking strategically -- thinking long-term -- if the shareholders' investment is to be maximized over the long term and if our businesses and our economy are to be able to innovate and produce the goods and services desired by customers. As an independent outside Board member, it has been my duty to encourage management to place the long-term interest of the business as a top priority. This is clearly the case in Phillips' recent corporate battles. As you know, Phillips is a large integrated petroleum company. The

petroleum industry is a high-risk, capital-intensive, long-term business. A company's success depends upon exploration to find and replace the oil and gas reserves produced. As you know Mr. Chairman, a company drills many more unproductive wells than successful ones in the search for oil and gas. A company exploring for new reserves, therefore, must be sufficiently strong to absorb such losses without jeopardizing the shareholders' investments. If it fails to find commercial oil or gas reserves, sizeable economic losses may be sustained and national security is seriously jeopardized. We should never forget the days of the Arab embargos and the long lines at the gas pumps. On the other hand, if exploration succeeds, a discovery probably will require years of heavy cash investment before production begins. For these reasons, the industry must quite often fund new projects from the internal cash flow from current operations. This equity or cash flow funding is necessary to protect the long-term value of the shareholder's investments. Management cannot look solely to short-term gains if it is to meet its responsibilities to shareholders, as well as to the energy needs of our nation.

To underscore my point: Equity...or cash flow funding...is an important feature of an oil company's capital structure. Substantial amounts of equity are necessary if a company is going to be effective in the oil and gas business.

When I served as the Secretary of Energy, my objective was to encourage company managements to undertake aggressive exploration and production programs to find new energy reserves - build for the future so this country had a more secure energy foundation. Companies have responded, increasing capital budgets, and research, to find the energy required by all Americans. The only problem is that stock prices have not gone up and managements are in double jeopardy -- knowing that they must invest to find new reserves, but seeing this reflected in a higher value for their asset base, not their earnings.

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This situation has been magnified recently because the market today prefers immediate return to the shareholders rather than steady growth as reflected in the future discounted earnings of the company. In my opinion, the market is more short-term oriented today than at practically any other time. The reasons for this are complex, Mr. Chairman, and I don't want to attempt to offer the committee a thorough treatise on its causes. However, I would like to point out three trends that bear heavily on this short-term orientation:

First, is the increasing presence of institutions as owners, or fiduciaries of owners, of America's corporations. Twenty years ago, more of the common stock of corporations was in the hands of the small shareholder. Today, institutions control some 60 percent of all the shares and carry out at least 75 percent of all the transactions occurring in the market. Private pension plans and the retirement systems of cities, states and public-employee groups now control assets worth in total close to $1 trillion. Estimates are numerous that the private and public pension plans own 35 percent of the equity capital of all U.S. corporations. And the managers of many of the largest U.S. companies don't need to be reminded that institutional ownership of companies they oversee often comprises 50 percent to 60 percent of the outstanding stock.

What does this mean? It means that ownership is no longer dispersed and takeovers are easier than before. Years ago, the difficulty of gathering stock from thousands of individual investors made hostile takeovers -- then called proxy fights -- a rarity. Today, with concentrated ownership, a raider can gain control of a company in a matter of days by offering a premium for the stock.

Why can a raider do this? Under the fiduciary relationship, institutional managers are obliged to seek the highest possible return on the funds entrusted to them,

consistent with an appropriate level of risk and in accordance with the rules and instructions of the respective trust or pension plan. Trustees, including pension plan administrators operating under the requirements of the Employee Retirement Income Security Act of 1974 (or ERISA), carry out their responsibilities accoring to the "prudent man" rule. This means that the trustees must use the care, diligence and skill that would be exercised by a prudent man in the conduct of his own private affairs. The standard of measure for what constitutes "care, diligence and skill" has been applied with varying degrees of strictness to the trustee. It appears that when hostile takeover attempts occur institutions are implementing the prudent man rule by accepting any premium over the current stock market price rather than holding a portfolio investment for appreciation in the future. This investment policy is mandated by the competitive necessity for institutional investment managers to show better performance than the market as a whole and than other investment managers. New business flows to investment managers on the basis of their investment performance compared to each other and to the stock market as a whole. Thus, they have a strong incentive to focus on short-term portfolio performance rather than long-term investment. In fact, this leads investment managers to manipulate the price they could ultimately receive from their stock. This is done most effectively in concert with the raider. Takeover entrepreneurs have, thus, gained the active support of major institutional investors. This further exacerbates the bust-up takeover problem.

Second, the market is becoming more and more dominated by the professional investment bankers, brokers, lawyers, and arbitrageurs -- who profit from market transactions. These people stand to gain from stock run-ups caused by hostile

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takeovers, from deals made to keep corporate raiders away from the target company's assets or from the search for a "white knight" company to bail out a target from a hostile raid. A company's stock goes up when a raider takes an interest in it, because scores of other investors -- mainly institutional holders and arbitrageurs -- trust the raiders' instincts for a good thing and know that, where there's a raider, there's usually fired-up stock value. It's almost a self-fulfilling prophecy: A stock rises when a raider buys it in large part simply because the raider has bought it.

Third, as I referenced earlier, institutional lenders -- including some Savings and Loans and pension funds -- no longer are shying away from riskier investments. These institutions are joining the corporate raider's ranks because they see huge returns with little risk. Junk bonds, as you know, Mr. Chairman, are debt instruments rated below investment grade by the rating services. They carry interest premiums above the investment grade obligations to compensate for the added risk. These instruments have typically been shunned by the conservative investor because of the high risk associated with them -- hence the perjorative name of junk. However, if the raider can convince a Savings and Loan, for example, that he will, in effect, secure his junk debt with the assets or cash flow from the target company -- a company he does not even own -- then the Savings and Loan's investment has little risk. In addition, the raider will probably provide the institution with an up-front "commitment fee" to sweeten the deal. Should the raider fail, the Savings and Loan loses nothing, even keeping the commitment fee. That was just for giving the raider the right to the loan at a later date. Should he succeed, then the target will be asset-stripped or have cash flow diverted to service and retire the debt. And in the meantime, the high-interest premiums from the junk bonds provide a substantial return to the lender. The historical "stigma", if you will, that lenders have had against investing in the junk market no longer holds.

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Nicholas F. Brady, whom you know as a former colleague and who is now Chairman of the investment banking firm of Dillon, Read & Company wrote an article appearing in last Thursday's (April 25, 1985) New York Times entitled: Equity is Lost in Junk-Bondage. His short piece on junk bonds provides good insight into the negative consequences of their use in hostile takeovers and supports the points I have just mentioned. He writes, in part:

> "Speculative, highly leveraged financing techniques involving junk takeover bonds, if unchecked, will leave misery in their wake. Junk bonds -- essentially high-risk, high-yield, less than investment-grade debt -- have long been around. What is new, and dangerous, is the rapidly expanding use of such securities to finance highly leveraged hostile acquisitions...These bonds entail substantial risks to investors -- risks that often have not been, and cannot be, adequately assessed...Why do many raiders, insurance companies, foreign banks, pension funds, savings-and-loan holding companies and a nationwide church join a junk takeover-bond syndicate? Because of substantial commitment fees, very high interests rates and the right to share in "greenmail" profits...What's worrisome is that junk take-over financing -- which is largely devoted to unproductive purposes -- dangerously threatens to destabilize America's national savings system. As we have seen in the collapse of ESM Government Securities Inc., when major investors reach for higher yields without regard for security and safety of principal, the results can be disastrous."

The point, Mr. Chairman, is not that lower graded high-risk debt is bad. Quite the contrary. What is wrong, in our opinion, is the use of these investments in hostile takeovers. They allow corporate raiders to gain access to

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financing that requires asset liquidation to be successful; results in the substitution of debt for equity; and transfers the risk to the small shareholder and the average American, who may, through his savings account in a federally insured savings and loan, be participating unknowingly in these transactions.

One final point on the use of junk bonds in hostile takeover attempts, Mr. Chairman, before I briefly address areas of public policy more directly within the purview of this Committee. Under current law, investors are able to take an income tax deduction for interest paid on borrowed funds to finance stock or asset acquisitions. We do not take issue with the income tax deduction for interest paid, except as it applies to junk bonds when used in a hostile takeover. We believe, that since these "debt" obligations are subordinated to other debt of the corporation and because of the very low amount of equity made available to finance the typical hostile raid, junk bonds used in a hostile raid should not be treated as bonafide debt under the tax code. These instruments resemble equity more than debt and therefore the corporate raider -- intent on securing a tax-favored distribution of the target company's assets -- should not be allowed this tax deduction for their use.

The equity nature of these securities is apparent. As was recently stated (New York Times, April 14, 1985, page 8F),

> "...after a cash tender offer gives control to an acquirer, the buyout can be structured so that the remaining stockholders receive junk bonds of a lower quality or preferred stock, which is junior to any debt obligations. While the value of those securities may be equal to the cash received in the first portion of the tender offer, those securities are at the bottom of the totem pole: when it comes to collateral, they are behind most securities received

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> by the original commitment group...In the event of bankruptcy, for instance, bank debt, senior bonds and notes and common stock have the first call on assets, ahead of most junk securities paid out to shareholders of the takeover company."

Thus, the junk bonds are virtually on a par with common stock -- at the "bottom of the totem pole."

Congress addressed a similar problem in 1969 over how to distinguish debt from equity in acquisitions. Then it enacted Section 279 of the Internal Revenue Code by limiting the interest deduction for certain convertible subordinated bonds used in corporate acquisitions. Congress decided that these bonds provided a "special and unwarranted inducement to mergers." The problem now is not convertible debt, but junk bonds.

Legislation has been introduced by Senators David Boren and Don Nickles (S.476) that would deal specifically with this issue by disallowing the interest deduction on junk bonds when used in a hostile acquisition and by imposing a 50% excise tax on greenmail profits. We support this legislation.

Mr. Chairman, my opening comment was that, in a nutshell, the basic problem with certain hostile takeover attempts was that they result in short-term profits at the expense of long-term performance which do not achieve the reinvestment requirements our society and our economy will need to continue to grow. Our point is that public policy should not help this process.

As independent, outside Board members, Mr. Laird and I believe the goals of public policy regarding corporate mergers and acquisitions should be to ensure that all shareholders are treated fairly and equally with full disclosure of all relevant information in a timely manner. Public policy should foster the free market, consistent with

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safeguards for competition. We should be driven by a desire to ensure that all sectors of our economy have an equal and fair chance in pursuing their interests and one (or more) is not disadvantaged by the application of public policy. Most importantly existing laws should not encourage highly leveraged corporate takeover attempts, nor discriminate against some stockholders to the benefit of the raiders.

For example, we oppose the practice of greenmail where some shareholders are paid a premium price above the market by management for their shares. Corporate raiders are making millions of dollars, in fact, solely from greenmail without actually succeeding in their hostile takeover attempts.

These takeover attempts usually proceed as follows, Mr. Chairman:

As you know, under our current securities laws, an investor can acquire up to 5% of a company's outstanding shares before he is required to make this knowledge publicly known - through the SEC 13D filing. And he has 10 days, after reaching 5%, to make his filing - during which he may continue to acquire the target company's stock. Therefore, a corporate raider, seeking short-term gain through liquidation of the target company, can establish a coercive beachhead at an extremely low price in the stock before the public-at-large knows what has occurred or can evaluate the market. In our opinion, any accumulation of stock by the raider is material information which the other owners of the company should have. Lowering the threshhold for 13D filings and eliminating the ten-day period for disclosure would be a step toward treating all shareholders equitably.

Also, Mr. Chairman, these hostile takeover attempts usually proceed as two-tier offers -- the first being a cash offer for a percentage of the shares that will give the raider control -- followed by the second tier offer that usually consists of securities, including junk securities

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for the balance. This system puts pressure on shareholders to tender with the first-tier offer or risk being offered a lower value in the second tier. Again, this process is not consistent with the public policy goal of equality of treatment for all shareholders and needs revision.

In our opinion, the Congress should consider whether there are certain features of the merger rules used in Great Britain that can be applied to our system. For example, as I understand it, offers to acquire 30% or more of a British company's shares are not normally permitted if the purchasor has acquired his shares during the preceeding 12 months and he does not propose to buy all the remaining shares for the best price he has paid for his shares accumulated over the previous 12 months. Such a procedure eliminates coercive two-tier offers and seems to ensure that all shareholders are treated fairly.

The final point I want to make Mr. Chairman, has to do with the Hart-Scott-Rodino Act, and its enforcement by the Federal Trade Commission. As you know, Hart-Scott-Rodino has procedures requiring persons to notify the FTC or the Department of Justice when acquisitions have occurred above certain threshholds. This law was enacted to provide the federal government with lead time to determine whether the contemplated acquisition raised antitrust concerns. It is apparent however, that the FTC is not rigorously enforcing Hart-Scott-Rodino when "partnerships" are created to serve as the acquiring vehicle. In fact, during testimony on April 16, before the House Energy and Commerce Committee's Subcommittee on Commerce, Transportation, and Tourism, James Miller, Chairman of the FTC and Timothy J. Muris, Director of the FTC's Bureau of Competition agreed that their own rules need clarification in this regard. I believe that the Senate

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Judiciary Committee should follow-up on this, Mr. Chairman, and hold oversight hearings on this matter. Today, corporate raiders, creating shell partnerships solely for acquisition purposes are avoiding the notification requirements and the intent of the law. Congress should determine why this is occuring and take appropriate corrective action.

In conclusion, Mr. Chairman, I want to make it clear that, as independent outside Board members, we see reason to be concerned over these hostile corporate raids that target strong companies, with the intent to profit in the short term from their dismantlement. As I said in my opening comment, this is the source of the abuse -- not the normal mergers and acquisitions occurring in the marketplace that have sound financial backing and that foster long term economic growth. Again, I am an ardent supporter of the American enterprise system and I make these recommendations for your review of these matters only after personal experiences with loopholes in the system. We believe, Mr. Chairman, that this Committee and the Congress can selectively amend appropriate federal laws and their implementing regulations to correct this problem.

I want to close by quoting from testimony given by Martin Lipton before the Senate Banking Committee's Subcommittee on Securities on April 3, 1985. He characterizes the hostile takeover phenomenon as follows:

The problem "...is the bust-up takeover and the extreme leverage that is being built into the structure of American business. While different in form, what we face today is not different in substance from what happened in 1928 and 1929. Leverage produces great results on the way up, but no economy ever goes up in a straight line and high leverage inevitably produces a crash when an economy turns down.

It is clear that abuse of the corporate takeover process has become a serious problem and is a threat to the economic system of the United States. On the other hand, as the takeover entrepreneurs have grown more aggressive, corporations have been forced to respond with defensive mechanisms to match them..."

The problem arises, as Mr. Lipton says, because of an abuse to the free enterprise system. Some sharp raiders and speculators have taken advantage of the system to enrich their pockets at a cost to this country's productive might, its national security, and its sense of fairness. This is the crux of the entire situation.

Thank you Mr. Chairman, I would be happy to answer any questions you or Members of the Committe might have.

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[illegible] OF SOUTH CAROLINA
171 ASHLEY AVENUE · CHARLESTON, SOUTH CAROLINA 29425

May 8, 1985

Mr. Michael T. Halbouty
Chairman of the Board & Chief Executive Officer
Michael T. Halbouty Energy Company
The Halbouty Center
5100 Westheimer Road
Houston, Texas 77056

Dear Mike:

Harlene Pakan sent me a copy of your article from The Houston Chronicle about corporate raiders. I think it's great!

I am taking the liberty of sending you, under separate cover, a copy of my recent testimony before the Senate Judiciary Committee on the same subject. Mike, this flaw really has to be corrected, and I look forward to working with you to get Congress to take corrective action.

I am also taking the liberty of forwarding a copy of your article to Senator Thurmond, Chairman of the Judiciary Committee, requesting that he enter it into the record so that your thoughts might be available for the Senate when they consider this issue.

Keep up the good work, and come see us when you are in our area. If you will let me know ahead of time, I'll even have Ann "bake a cake"!

With warmest personal regards,

James B. Edwards, D.M.D.
President

JBE/lj

cc: The Honorable Strom Thurmond (w/enclosure)

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Medical University of South Carolina
171 ASHLEY AVENUE · CHARLESTON, SOUTH CAROLINA 29425

May 7, 1985

The Honorable Strom Thurmond
United States Senator
209 Russell Office Building
Washington, D. C. 20510

Dear Senator:

Enclosed is a copy of an article by Mike Halbouty that sheds some much-needed light on the corporate take-over problem. I thought you might want to enter it into the record so that your Committee will have this information available to them as they try to take some corrective action.

Senator, I certainly do appreciate your courtesies when I appeared before your Committee in Washington but, more than that, I appreciate your holding these hearings in an attempt to clarify and rectify this situation.

Keep up the good work!

With warmest personal regards,

John B. Edwards, D.H.D.
President

JBE/lj
Enclosures

Strom, as you know Mike Halbouty is one of the most knowledgable men in the Oil industry, and a true patriot - He is one we should respect when he speaks out as he has on this issue — Thanks Jim

[The Houston Chronicle]

## Look What Corporate Raiders are Doing to Life in Houston

(By Michel T. Halbouty)

Halbouty is a Houston geologist, petroleum engineer independent oilman.

Hostile takovers and takeover threat have become a blight on our free enterprise system and a most destructive threat to the domestic petroleum industry and its workers, related businesses and their workers, our national security, our national economy and the well-being of the American people as a whole. That blight takes the form of corporate raiders—arbitragers, greenmailers, sharks—the cold, calculating profiteers who in my opinion care more for personal gain than for the industry they are infiltrating and weakening they are infiltrating and weakening in the name of "shareholders' rights." The moral, ethical and social foundations of our free enterprise system are being ignored. No greater threat to the stability of free enterprise has presented itself since the robber barons of the 19th century.

The United States' business and industrial complex is fueled primarily by oil and natural gas supplies. A healthy and expanding petroleum industry is necessary to provide new reserves the country must have in order to compete successfully. But hostile takeover threats to petroleum companies today have little or nothing to do with increasing our economic growth or fostering productivity. Instead, they undermine productivity, provoke chaos and have for entire communities, and burden companies with billions of dollars of excess debt.

Future profits are subject to erosion in both bidder and target companies as a result. Takeovers of this kind appeal to the raiders only because our current laws and tax policies provide incentives for the raiders. I can only surmise the raiders believe that it is more profitable in the short run to buy assets than to build them, and easier to abandon and/or liquidate companies than to have them expand.

The short-term effects of hostile takeover threats are unemployment and economic losses to the communities in which the target companies are located. Corporations can take defensive measures; but employees, their families and communities have no defensive measures. They are vulnerable! Houston and its surrounding area are suffering a recession caused primarily by the slowdown in the petroleum industry over the past few years. The current surplus of world oil and gas has forced extensive cutbacks in the industry. In addition to our existing national economic problems, thousands of company employees and their families in Houston have been affected as a result of the raiders' tactics. Thus, Houston's economy has lost property and real estate taxes, and its businesses have lost customers for their goods and services. But more importantly, there is no way to replace the loss our community has suffered. Its charities, churches, colleges, hospitals, museums, ballet, symphony and public television—to name just a few areas—have suffered the loss of civic-minded contributors of time and money.

Another slap in the face to Houston's economy is the role played by some of its lending institutions. Houston is recognized as one of the leading oil centers in the world. This region's access to credit for business investments or expansion is reduced in direct proportion to the amount of credit awarded the raiders. In plain dollars-and-cents words this means that the more money the raiders have to use to threaten companies with hostile takeover bids, the less money is available for other productive commercial ventures, whether that money is needed by a petroleum company or any other Houston business. Moreover, the credit extended by lending institutions to the raiders actually comes from investors, from you and me, from taxpayers, from shareholders, from companies. In essence, I believe that we lose in many ways—our money is being used against us. We pay the costs of excessive debts. We are deprived of future profits. We are all hurt by hostile takeovers. I also believe that only the raiders gain, with no apparent regard for anyone but themselves.

The greatest single long-term effect of hostile petroleum company takeovers is one that will affect the entire nation. When huge debts are repaid, exploration programs suffer, therefore the search for new oil and gas reserves is curtailed or severely limited, which lessens our opportunities of making discoveries to replace our diminishing oil and gas reserves. As a result of this downturn in exploration, our national energy security is threatened. Without a strong domestic energy base, we are at the mercy of foreign governments, companies and cartels. Furthermore, as exploration is reduced, production of existing supplies is limited and imports will rise, leading to increases in our foreign trade deficits and, in turn, leading to higher inflation. As a result, we will be forced to depend on foreign supplies simply because we will be unable to meet our energy needs.

The current worldwide oil surplus is temporary, and we could witness another energy crisis in as little as five years. But the United States does not have to be in a position of energy dependence. I have said for many years that the key to unlocking our vast domestic petroleum potential lies in our innovative thinking and our daring.

Without optimism no oil or gas will be searched for, and none discovered. Yet, one more threat to the petroleum industry is the negativism and pessimism the raiders spout as rationale for their "protection of shareholders" bids. The media are told that the petroleum companies are throwing away huge cash-flows in exploring for new reserves in high-risk areas, that the price of oil today does not warrant exploring and drilling in frontier areas, that there are no more prospects to be drilled in this country, that the petroleum industry is a sunset industry, that replacing reserves is all but impossible, and that the industry has no hope of survival in its present form.

The implication is that there's no more oil and gas to be found, that there's no need to search anymore, that petroleum geologists, petroleum engineers, geophysicists and other industry professionals are unneeded and becoming obsolete. Because of such negativism the future enrollment of our young men and women for petroleum-related studies will surely suffer. This, in turn, will have an adverse effect on the petroleum-oriented facilities and departments in our colleges and universities.

The implication that there is no future for the petroleum industry says to those of us in it: You belong to a dying industry. I disagree! The industry's future is bright and it will thrive for many decades to come. There have been many in the past who proclaimed its doom. They have all gone and the industry survives. These present-day raider-doomsayers will also pass away and will probably be likened to the robber barons in years to come.

We must continually progress, which means the only way our petroleum in industry can grow is for us to explore and add to our reserve base, not to liquidate. Every region now producing was once a frontier—Spindletop, East Texas, Titusville, Appalachia. The Overthrust Belt and Prudhoe Bay on the North Slope of Alaska, to mention only a few. Frontier areas were successfully drilled and discoveries made when oil was selling below a dollar a barrel and under worse economic conditions that now exist.

New oil and gas field discoveries in this country, and worldwide, are announced almost daily. Yet, without those companies and individuals who elected to sustain the risks, many of those areas might still be frontiers an our nation's growth and industrial complex would have been severely restrained. Geologists, geophysicists and researchers are fully aware that there remains a huge petroleum potential in this country yet to be explored. We should not accept the pessimistic premises that there are no good prospects remaining, that the petroleum industry is in a state of self-liquidation, that replacing reserves is all but impossible, that in essence we should stop exploring or only support the least costly exploration programs. This is pure tripe.

There are thousands of prospects yet to be drilled in the United States. But we must drill those prospects to find the potential reserves. Drilling for oil on Wall Street does not add one drop of new oil to our reserve base. In fact the opposite occurs, as the raiders' liquidation strategies will lead to lesser exploration efforts, fewer discoveries and greater dependence on foreign sources.

If our major petroleum companies continue to be looted by the raiders, we won't be able to compete successfully in the world petroleum market. We won't be able to adequately explore the high-risk frontiers. Research and development breakthroughs in alternate energy sources that are needed for our post-oil period might not be made for lack of funding. The oft-times life-savings discoveries that accompany much of the research conducted by our diversified petroleum companies may also not be made. With companies liquidated, capital depleted and credit scarce, it is highly doubtful that sufficient wells will be drilled to replace our reserves and provide the petroleum energy security this country needs.

The growing number of hostile takeovers and threats of takeovers in all areas of American business has drawn enough attention nationwide that last year Congress began the process of reviewing our existing legislation designed to protect all parties in business negotiations from unsound and deceptive practices. Bills have been introduced but stalled, congressional subcommittees have heard testimony from raiders, corporate officers, investment bankers and government officials. Our legislators have heard the raiders state that the tactics they employ are perfectly legal, protect shareholders' rights, and don't hurt anyone. However, our legislators have also heard what companies have suffered what their employees and employees families

have suffered, and what the national impact has been and will be if the raiders continue.

The victim company suffers in many ways—morale and teamwork are crushed; many loyal and dedicated employees are forced into early retirement or dimissed; families are disrupted; mediocrity permeates the entire corporate structure; enthusiasm is replaced with lethargy; fear and humilitation reign; creative and high risk projects are discarded; momentum comes to a halt and the company slowly dies from shear inertia. We cannot silently stand by and permit this to happen again and again.

There's more at state than whether a company can defend itself again an unwanted takeover. There's more at state than loss of jobs and relocation of families

What is at stake is our accepted way of doing business in America. Hostile threats and takeovers affect every stratum of society. When a large corporate entity disappears, communities, cities, regions, states and the nation itself lose an invaluable part of their identities.

We must restore our faith in doing business with each other without fear of being torn apart; we must believe in doing business with a feeling of professional pride that all parties were treated fairly; we must abide by the principle of protecting investors by maintaining ethical standards beyond reproach. By adhering to these precepts the confidence in our capital system is preserved. These objectives should be uppermost in the public's consciousness.

Senator MCCONNELL. Senator Grassley.

Senator GRASSLEY. Mr. Chairman, I am just going to ask to insert a statement.

[The following was received for the record:]

OPENING STATEMENT OF SENATOR CHARLES E. GRASSLEY

Thank you, Mr. Chairman.

The increasing occurance of hostile acquisitions of major corporations by other companies and investment groups has caused a great deal of concern among those charged with promoting competition, underwriting financial markets, and those who live and work in cities where the major employers are likely targets of a corporate takeover.

S. 473, would declare a six-month moratorium on hostile corporate takeovers in the petroleum industry. During that period, the Secretary of Energy would be charged with investigating the effects of further corporate takeovers on the industry, the Federal Trade Commission would study the impact on consumers, the Securities and Exchange Commission would study the use of so-called "junk bonds" in the acquisitions, and the Federal Reserve Board would study the impact on the credit markets.

As one who believes that the government should not intervene in the marketplace unless it is absolutely necessary, I hope each of the witnesses today will address that concern: is the problem of hostile takeovers of one corporation by another, so injurious to the nation as a whole, that it is deserving of Congressional action; and, if so, is a six-month moratorium an appropriate course of action?

Senator GRASSLEY. I do not have a question for you, Governor Edwards, but I appreciate your being here and I appreciate hearing your testimony. I am sure that my position is similar to a lot of other Republicans on this committee who have some reluctance to interfere in the marketplace, but there may be problems out there.

Quite frankly, we are just learning of those problems and I think that I would want to say that if there is something that needs to be done, and I am willing to keep an open mind on it. At least from my part there will have to be a burden to support action; not just some evidence of necessity, but a fair burden to show because I think we want to make sure that what we are doing in this area is legitimate Government activity.

These proposals that propose a study of mergers, I think—I am not sure of the 6-month moratorium, but at least to the extent to get more information—are probably legitimate because we need to

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look at, and looked at very quickly, these problems if, in fact, there is a problem.

Thank you, Mr. Chairman.

Senator MCCONNELL. Thank you, Senator Grassley.

Senator Hatch.

Senator HATCH. I am concerned, Governor Edwards, with the financing of takeovers.

Mr. EDWARDS. With the what?

Senator HATCH. With the financing of takeovers. I do not know what your experience is, but have you seen any difficulties with the financing of takeovers? For instance, if a takeover attempt is made and the person making the takeover has the wherewithal and capacity to put together the right team to take over a corporation, do you think there should be any laws governing the fairness of distribution of financing of such takeovers?

Mr. EDWARDS. Senator, the takeover entrepreneurs today are using our Tax Code, and it provides an advantage to the hostile raider, our Tax Codes do today. Now, if a person wants to take over another company and they have their own assets of the number one company up front invested in the takeover of the second company and they are willing to risk those assets, I see nothing wrong with it.

But the way it is done today is that the takeover entrepreneur will create a sheli company and then under the guise of helping the stockholders they go in and they arrange with Drexel Burnham, for example—they will arrange with Drexel Burnham to mortgage the assets of the company being taken over with junk bonds to finance their actions as a raider.

Senator HATCH. I see.

Mr. EDWARDS. They are not mortgaging their own assets to do it, but they arrange with Drexel Burnham to go in and mortgage the soul of that company they are taking over.

Senator HATCH. I see.

Mr. EDWARDS. Then they go back and they go through their proxy fight, and if they win the proxy fight then they are mortgaging that other company and they take that company and put it up for security with these junk bonds.

Senator HATCH. I see.

Mr. EDWARDS. Senator, these junk bonds, as you know, do not have the greatest credit rating.

Senator HATCH. Yes.

Mr. EDWARDS. But they are pretty secure investments when you look at it by the fact that, for example, they are mortgaging Phillips Petroleum to finance our own takeover.

Senator HATCH. Governor, let me ask you a question.

Mr. Chairman, I am wondering if I could ask a special favor. I understand Mr. Pickens is still out there, and I arrived here late because of other conflicts. I would like you to ask him to come back in and let me ask him some questions as well.

Mr. EDWARDS. I will be happy to yield.

Senator HATCH. Do you mind?

Mr. EDWARDS. No, not at all.

Senator HATCH. You are a friend of mine, Governor. I know you will not feel that I am imposing on you. I have much respect for

you, but I want to make sure that I ask some of these questions because I have been concerned about just what is the financing available, who handles it, is it fair—especially with regard to pension financing.

Obviously, as chairman of the Labor Committee, I have been concerned with all of the pension approaches that we have. I am also concerned with who controls those pension money and are they utilized in the best interests of the pension holders. Are these takeovers part of that process?

Mr. Pickens, I am sorry to call you back in, but I had a couple of questions I wanted to ask while Governor Edwards is still here.

Mr. EDWARDS. I yield.

Mr. PICKENS. Thank you, Governor.

Senator HATCH. I have been concerned about financing behind these takeover attempts, whether it is fair, whether it is adequate, whether it is using pension funds, and how these funds are used.

For instance, considerable attention has been directed at the financing you have arranged as part of your Unocal tender offer. I am interested in what you have learned in the course of your activities to take over Unocal with regard to financing, the banking system, pensions, the use of pension funds in financing.

Do you believe that the credit is available and open on a competitive or equal basis—for both sides—those who want to prevent the takeover and those who want to participate in the takeover?

Mr. PICKENS. Well, my feeling about the financing——

Senator HATCH. I am asking, What is your experience?

Mr. PICKENS. OK. Let me say first that the initial financing in the Unocal deal for us—we borrowed $1.1 billion on Mesa's oil and gas reserves. I mean, there is no junk bond financing.

Senator HATCH. You are talking about Unocal, the Unocal offer?

Mr. PICKENS. In the Unocal offer, the first thing we did was we borrowed on the Mesa reserves to purchase the Unocal stock. Our $1.1 billion is in, and then we have another $600 million which comes from that side which would go into the transaction, too—$1.7 billion.

Now, that is ours; it is in and it is the last out. Now, we finance $3 billion.

Senator HATCH. On top of that?

Mr. PICKENS. $3 billion on top of that, and that is identified as the high-yield junk bond financing.

Senator HATCH. Have you had any difficulty raising the additional $3 billion?

Mr. PICKENS. We raised it in 4½ days. Our $1.7 billion is in ahead of that. In the event there is any loss, we lose our $1.7 billion first. Now, the people that are buying junk bonds—you need to look at that, Mr. Hatch, to see who those individuals or companies are.

You know, some of the biggest buyers of junk bonds are IBM pension fund—I believe Procter & Gamble is another one, Prudential Life Insurance Co. So you are talking about people that are buying so-called junk bonds. I mean, we are not talking about people that are unsophisticated. I mean, they are just not out on the street signing people up. How would you like to have a junk bond?

I mean, you are talking about people that are buying in denominations of $10, $20, $50, $100, $200 million. These people have researched; they look at this situation, they know exactly what they are buying.

So, you know, do not have the idea that the purchasers of these bonds are individuals that are being taken advantage of.

Senator HATCH. Then I take it from what you are saying here, that you believe the credit is openly available on a free, open, and competitive basis for takeover attempts?

Mr. PICKENS. It is, with one exception.

Senator HATCH. What would that be?

Mr. PICKENS. Well, on our bank financing, the $1.7 billion, for instance, we have no New York major banks.

Senator HATCH. Well, you know, I cannot imagine you having difficulty with the experience you have had in getting New York banks to open up to you.

Mr. PICKENS. Well, to quote a loan officer at a major bank, he said that Mesa Petroleum is gold plated; "you have excellent reserves, you have excellent cash flows, you have an excellent record of repayment, and you do not quibble over fees, but we cannot take you as a customer."

Senator HATCH. Why was that? If you meet all those requisites, What would be the problem?

Mr. PICKENS. Because it was explained to me that we have other customers that do not want us to do business with you, and they are larger customers than you are.

Senator HATCH. Well, is that not a legitimate concern?

Mr. PICKENS. You bet it is a legitimate concern of ours because we cannot get a——

Senator HATCH. I mean is it not a legitimate concern on the part of the bank?

Mr. PICKENS. You mean that they would do that?

Senator HATCH. Yes.

Mr. PICKENS. Absolutely, I would think it would be. But we cannot get a money center bank in New York. Marine Midland, which is not one of the larger banks in New York, is one of our banks, but we cannot get Citibank, Chemical, Manny Hanny, Morgan Guaranty—down the list you go—we cannot get any of those banks to bank us, nor can we get the two large banks in Chicago.

Senator HATCH. If you have got a gold-plated company, Why do you think that is the case?

Mr. PICKENS. Because we are getting tremendous pressure put on us for the activities that we are involved in, and what happens is, it is the Business Roundtable again. But the largest corporations in America are putting pressure on the banks: do not do business with Boone Pickens. It is that clear.

Senator HATCH. Do you really believe that?

Mr. PICKENS. I know it is a fact. I can demonstrate that for you.

Senator HATCH. I have a concern with regard to the interests of workers under our revisions laws. For instance, fiduciaries acting on behalf of these workers must exercise independent judgment in managing pension funds.

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Of course, as Chairman of the Labor Committee, we deal with the ERISA laws and pension funds all over the country. The question of their independence often arises when these pension fund managers also have banking interests which could conflict with their role as fiduciaries.

I do not know whether you have had much contact or much experience in dealing with pension fund managers.

Mr. PICKENS. I have.

Senator HATCH. What types of pension funds?

Mr. PICKENS. Well, see, that is a concern to me, also.

Senator HATCH. Why is that a concern?

Mr. PICKENS. Because we have been in proxy fights, and we are in one right now, where we find a rather interesting situation where you have pension fund managers that are actually—I mean, they are out there, able to stay in business because of their performance. Because of their performance, they stay in business, so they are competitive and they have to show results.

Second, you see some pension fund managers around, and mostly in the trust departments at banks—I say pension fund, but they have the same type of funds that they are looking after—they are not in the same competitive position.

If you will notice on the voting—and we can give you some information on that.

Senator HATCH. Would you provide that to the committee?

Mr. PICKENS. I think we can, yes. It may be after this proxy fight that we are in with Unocal because we do not have any conclusive information at this point until it is over with.

Senator HATCH. All right.

Mr. PICKENS. But, also, we can see here that those pension fund managers that are in a competitive position are more willing to vote against a management when they believe that the analysis proves that that is what they should do.

In those that are not in a competitive position and are trying to get those types of funds and their results are not being measured as close by as pension fund managers; they are willing to go along with the status quo. They get tremendous pressure.

Listen, there is not any way in the world anybody can convince me that there is a Chinese wall in a bank. I just do not believe it. I think that the trust department has great pressure put on it in, I would say, 90 percent of the cases by the commercial lending side.

If I might just read these three paragraphs, if I could, this is a June 3, 1984, interview with Harold Hammer, who is executive vice president of Gulf Oil Co. Now, this is after the Gulf-Chevron deal was done and the interview was done with the Tribune Review in Pittsburgh.

Hammer admits surprise at the high credibility Boone Pickens achieved with the news media, and not only with the media during his own personal canvassing in last December's proxy contest against the Texan. Hammer ran into unusually hostile proxy committees at several major banks. Invariably, they seemed to be manned by 28-year-old MBAs, a lot of them women.

These folks seemed to share with Pickens a propensity to believe the worst of so-called big business—entrenched, self-protective management. On some occasions—

And this is what I want to underline—

On some occasions, Gulf executives had to phone the bank's chairman to reverse the proxy committee.

Now, that, I think, is an admission that is very clear, that tremendous pressures are brought to bear on these banks to vote with management.

Senator HATCH. I have to admit you have made some serious charges here against the Business Roundtable. You are saying that the Business Roundtable as an organization actually uses its pressure to try and——

Mr. PICKENS. OK. To clarify, I will say members of the Business Roundtable have brought pressure. I do not think all members of the Business Roundtable—I do not think it is a conspiracy that they have—I am not saying it is the whole Business Roundtable or it is their policy. I am saying it is the large companies in the United States, most of them members of the Business Roundtable.

But one point on the banks: here, we were a customer of Security Pacific for 12 years. Unocal was a customer of Security Pacific for 40 years. Security Pacific came to us after we were a known owner of Unocal and said that they would like to get out of our credit.

Unocal knew very well the situation because they brought that pressure to bear on Security Pacific. Now, it is my feeling that banks are in the business to loan money to creditworthy customers. They are not to make moralistic judgments as to whether this company is after that company.

When we have been called on by our banks—could we participate in a credit line for Phillips, for instance, for $5 billion? We said sure. If they are a creditworthy customer, we do not care; go ahead and loan them the money.

Here, Unocal came back and filed suit against Security Pacific and then proceeded to try to intimidate all of our other banks by sending them an unmarked envelope which we verified. We know exactly where it came from; they have admitted it now.

They sent it to Members of Congress and the Senate; they sent it to all of our banks, bank directors; sent it to their homes with the lawsuit, with the pleadings, in the envelope, along with a letter to Chairman Volcker. That is all that is in it—no cover letter, no indication of where it came from, no markings on the outside of the envelope.

They sent it from New Jersey, and sent it out—this is a California company—sent it out to all these different places. Why? I can tell you exactly why, because they were trying to intimidate those bankers to tell them, if you continue to loan Boone Pickens money, we are going to do the same to you as we have done to Security Pacific. That is exactly what they are up to.

Senator HATCH. Now, as I recall listening to you in the past, you have been very critical of managers and boards of directors with regard to whether or not they act in the best interests of the people they represent.

In your experience, how do directors protect themselves against shareholder suits, against criticism by shareholders, in this modern day and age when they get into one of these proxy fights or into one of these takeover attempts, and is it wrong or is it right?

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Mr. PICKENS. Well, you have got a situation going on right now, which is incredible, that Unocal is taking on more directors' liability insurance and it is a magnitude of $50 million.

Now, they have $30 million, I believe, and they are taking on another $50 million.

Senator HATCH. What is wrong with that?

Mr. PICKENS. Well, what is wrong with it is that, from our information, and I believe it to be entirely accurate, they are paying $50 million for the $50 million worth of insurance. That is what is wrong with it.

We are a stockholder of that company and if that is not a misuse of stockholders' funds, I do not know what it is. I am not talking about paying $1 million for $50 million worth of insurance. I am telling yo they are paying $50 million for $50 million worth of insurance. Incredible, is it not?

Senator HATCH. Well, I had not heard of that before.

Senator BIDEN. Who is their insurance company? [Laughter.]

Senator HATCH. Yes. How do you get into that business?

Mr. PICKENS. Well, I think what you are hearing is that they have some real directors' liability there and they are having to pay a substantial amount of money for their insurance, and this gets into Delaware law now as to circumventing some things to protect their directors.

But this is a situation that is extremely serious that anybody would go out and pay $50 million for $50 million worth of insurance.

Senator HATCH. I must tell you, I am in a quandary myself over all of the activities that have occurred with regard to Mr. Icahn, yourself, and others. I remember the battle over the so-called merger moratorium with regard to petroleum companies and I felt that you were right in that battle.

However, I am extremely concerned about the number of takeovers that are going on today and, as you know, hostile takeovers seem to be the focus of much of the debate in this policy area. Now, I would like your views concerning this type of economic activity. What is right about hostile takeovers?

If you can tell us what is wrong about them, I would like to know that as well. In your viewpoint, are they healthy for the economy and consumers? I feel sure that you will say they are, but I would like to hear it from you. I would like to hear why you think they are healthy, if they are, and what is wrong, if there is anything wrong.

Do you disagree with any of the hostile takeover approaches that are going on in our society?

Mr. PICKENS. Well, a hostile takeover is merely—what is hostile or friendly is merely in the mind of the chairman of the target company. Now, he will tell you that his outside directors should make this decision, but I do not believe that for a minute. It is going to be what the chairman of the board wants to identify as friendly or hostile.

If it does not include him in some special category, it is usually hostile. So as far as hostile being good for the consumer and the American people, I think it is absolutely the finest thing that has happened in my 35 years of business because it is jerking some

managements around and getting them back on the job and doing the things they should be doing, which is working for stockholders.

Senator BIDEN. Do you mind if I——

Senator HATCH. Sure.

Senator BIDEN. Do you have any evidence of that?

Mr. PICKENS. Sure.

Senator BIDEN. In other words, can you tell us how you reach that conclusion?

Mr. PICKENS. That it is jerking——

Senator BIDEN. That it will produce the effects that you have just stated.

Mr. PICKENS. OK, I will quantify it on the deals I have been involved in. Will that be——

Senator BIDEN. Sure, sure.

Mr. PICKENS. You have got a man coming up here today, I hope, Michael Jensen, whom I had never met until in the hall 15 minutes ago, but I have read a lot about what Michael has said and he can give a much broader view as to how it impacts the overall picture. But I can tell you what has happened on deals we have been involved in.

We have been involved in—the first one was Cities Service, General American, Gulf, Phillips, and Unocal. Now, the Unocal deal is not over with yet, but already there have been some fine things that have happened to those stockholders.

The total in that is about 900,000 stockholders have made a profit off of their stock; the market value enhancement has been $15 billion. What I have just been handed is what each one of them has done, but it would be about $15 billion off of those companies, which would give the Federal Government about $4 billion in taxes.

So that in itself—not the $4 billion to the Federal Government, because that is not my role to be out shagging taxes for the Federal Government.

Senator BIDEN. We need the help.

Mr. PICKENS. I understand, and let me tell you there is not anybody that enjoys paying taxes more than somebody that has made a big profit. I mean, that is an easy call. They do not want their taxes raised, but they do not mind paying taxes if they win. So, here, you are seeing that in itself.

Now, that money has gone right back; that is $15 billion in profit. That is not the gross; I am talking about pretax, the $15 billion. But that has gone right back into this economy. It does not disappear; it is a $15 billion profit that goes back into play somewhere, plus their original investment, their equity in the deal.

So, here, you have got money being moved around, which we all know is good, if you have got money being moved around and going into good investments.

Senator BIDEN. How is it affecting the consumer? It could be just moved around so that the consumer ends up paying a bigger price for whatever the product is.

Mr. PICKENS. But that is not the case.

Senator BIDEN. I am not suggesting——

Mr. PICKENS. Yes, I know, but we can demonstrate that that is not the case; that, by the combination of these companies, there

are efficiencies derived from that and, actually, the consumer comes out well.

In all the deals that you are going to do—and there are going to be a lot of these done and there are going to be a lot of managements that are going to look at the situation. I think there has been enough written on this and most of you have seen it. If you have not, we would be glad to supply it to you.

Senator HATCH. Would you please provide for the committee what you consider to be evidence that these mergers have been beneficial to shareholders. As you know, there is no question in my mind in the case of Gulf—which was kind of sitting there, not very aggressive, not really doing what a lot of people thought Gulf should do, and with shareholders kind of locked in—that many Gulf shareholders feel that Boone Pickens is a hero.

Now, I do not know how some of the other shareholders of the acquiring company feel at this particular time. However, the Gulf shareholders—the ones I talked to, thought you were a hero. The reason being they felt they had been locked into a company that was not aggressive and was not really doing what its assets dictated it should have done. You made all those points when you were here before.

Mr. PICKENS. Well, the level of sophistication has gone up tremendously by the stockholder because of what has happened, which is good. It is their money and they should know what is going on.

Senator HATCH. What you seem to be saying is that this is part of the law of supply and demand, this is part of the economic system, this is part of what makes our economy go, and that this is part of what keeps people on their toes. This may be beneficial to shareholders, although, it may not be in some circumstances. I do not know, but let me get back to that original question.

When you indicated that you feel certain pressures have been put on at least the New York banks which you have singled out, other than Marine Midland——

Mr. PICKENS. Exactly. In fact, Citibank dropped us because Phillips told them after the deal, we are not going to do any business with you if you continue to do business with Boone Pickens. This is after we are already through with Phillips. It is after Bill Douce, their chairman of the board, has said give the devil his due.

Senator HATCH. That is what I missed. You see, apparently, I had difficulty seeing any problem with a bank whose major customer may be Phillips saying we do not want to loan money to you to take over Phillips. I think maybe that is not the problem that some people might think, but maybe I am wrong.

However, you seem to be saying that after the deal with Phillips was concluded and you were out of it and you were another business person with a gold-plated borrowing package, in the business of trying to find money to be able to go out and do your business, you were foreclosed from dealing with Citibank because Phillips was mad at you and just said, if you do business with Boone Pickens, we will not do business with you.

Mr. PICKENS. That is right. That is what I am saying, and I am even going further to say that there is pressure put on these banks

by companies that are totally unrelated to us. They are not even in the oil industry.

Senator HATCH. But that cannot be very widespread, can it? I mean, New York banks are kind of laws in and of themselves. I cannot imagine them being intimidated by any one company if they can make a decent loan to a company like yours that is, as you describe it, gold plated.

Mr. PICKENS. That would be my feeling if I were a banker. I would say I am going to loan to whoever is creditworthy.

Senator HATCH. But you are saying this is widespread and that you have been basically foreclosed from the New York financial markets, at least from the bank markets, your reason being, I would guess, unfair competition and unfair pressure. If what you are telling us is true, I would have to agree.

Mr. PICKENS. Absolutely. This has been the approach of the other side every time we have been involved. Go get the banks and break them up; break up his financing, cut him off from money, and we can stop him. Now, that is the whole attitude of it.

Now, it has gone so far that we have got companies that are unrelated; I am talking about companies in other industries that do not even know Boone Pickens, that I have never even shaken hands with the CEO's, that actually call these banks and say we do not like for you to do business with Boone Pickens. That is what I am saying.

Senator HATCH. And then they back off and do not do business?

Mr. PICKENS. Exactly, and we are frozen out from those funds from the largest banks in the United States because those kinds of pressures are applied to those banks.

Senator HATCH. Do you see any legal difficulty with that type of occurrence?

Mr. PICKENS. Well, I would just as soon not comment about that one.

Senator HATCH. Do you suggest that we as Members of Congress should do anything about that?

Mr. PICKENS. I think that any time you have that kind of interference from outside on any banking institution, I think it is worthy of investigation.

Senator HATCH. Well, I would like to think that our banking institutions are free and open and would lend to decent borrowers without intimidation by others, but if what you say is true, my assumption is not right. I do not know how legal it is, but it may not be right, however, it does seem to me that you have some recourse there.

One last thing: if I have interpreted you correctly, you are saying that with regard to some of the pension fund managers, some of the larger pension funds managers, they may not be acting in the best interests of their pension fund holders or the workers who have——

Mr. PICKENS. In some cases I think that pension fund managers are prone to go along with the status quo. They do not want to upset management. They will not talk to me; they will freeze me out on information. I will not be able to get good analysis of the company, and I do not want to upset them.

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For instance, the point that right now is so important to the Unocal stockholders is that we have asked for 60 days for the stockholders to have a chance to look at what the offers are on the table. All we have asked them to do is put off the stockholders meeting for 60 days.

I mean, that management and that board of directors at Unocal—they want that meeting as quick as they can have it so they can entrench themselves for one more year that is what they are after. Some of these people are going along, voting with the management, when all you are saying is we are not voting on any economic issue.

The extension is nothing more than saying let us just look at the offer for 60 days. The board of directors of Unocal have an offer out there that says we are going to pay you $72 for 50 million shares, but they do not say when. I mean, the thing is all strung out; they do not know where they stand, the stockholders.

And it just so happens that the date for that final decision to be made—if the stockholders meeting comes off on May 13, the Unocal board of directors will not have to make that decision until after May 13 as to whether they are going to take down that 50 million shares at $72 or not.

Now, I know this gets complicated, but just remember those two dates. The date for decision is after the May 13 date for the stockholders meeting. We are saying give us 60 days. I want to see if that management is going to do what they say they are going to do.

We are their biggest stockholder and it is of utmost importance to us. We have over $1 billion invested in this company, and this is the same guy running this company that is shuffling these dates around and trying to entrench himself that stood right out here in the hall and said to me when I tried to shake hands with him—he said you do not deserve to shake my hand, and we were their largest stockholder.

Senator HATCH. Well, I have other questions, but I will submit them in writing. I have just been intrigued about these particular areas and I have heard some of the comments about them. I just wanted to ask you some personal questions about them, and appreciate your being willing to come back in and testify.

I appreciate you, Governor, for your willingness to be interrupted. These were important questions to me.

Senator MCCONNELL. Thank you, Senator Hatch.

Senator HATCH. Thank you.

Senator MCCONNELL. I, too, want to thank you, Mr. Pickens, for coming back. This is Boone Pickens, round 2, Senator Biden. Do you have any questions for Mr. Pickens?

Senator BIDEN. Well, Boone Pickens is right now the heavyweight champ, and that is why they need to have round two.

I am not sure whether you are Robin Hood, Mr. Pickens, or whether you are a bum. I do not know which it is, in a business sense.

Mr. PICKENS. Look at what all those stockholders have made.

Senator BIDEN. Yes, that is true.

Mr. PICKENS. My mail is running 10 to 1 "for." [Laughter.]

Senator BIDEN. I will bet it is. Let me ask you a few questions. You have made a fairly persuasive case about how you have been

frozen out by the major banks. Is that the reason you went to the junk bond market?

I mean, had you not been frozen out, would you have gone the route that you had to go?

Mr. PICKENS. No. We replaced those banks with other banks.

Senator BIDEN. OK, so there is no connection between——

Mr. PICKENS. No. We were not forced to go any direction. It caused us a lot more time and expense. But, you know, get some of these bankers in here and ask them some of these questions and see how they are shuffling this credit around. It would be interesting to hear.

Senator BIDEN. Yes, I am kind of interested to do that.

Senator HATCH. I would have to admit I am, too. I think that might be something worthwhile.

Senator BIDEN. I would be interested to hear the answers to that.

Let me ask you, also, Atlantic Richfield, Arco, announced they were moving West. As I understand it, you indicated some news account that that was a pretty smart management move to make, but then as I turned on—it is of a parochial concern. Not that anything would be changed about it, but it has gotten a lot of coverage in a little State that your people spend some time in, Delaware, because the Atlantic Richfield refinery in Philadelphia is very closeby.

So there has been a lot of discussion, at least regional discussion, about why it was done. Some of the analysts we have been listening to indicate that it was done to avoid hostile takeover attempts in the future.

Mr. PICKENS. You are smiling.

Senator BIDEN. Well, I am just wondering. I do not know a whole lot about this area and I am here to learn.

Mr. PICKENS. Well, I even had one--I do not know whether it was in the New York Times or the Wall Street Journal or the Post, but it said, you know, that they were trying to get away from Boone Pickens.

Well, any analyst that makes that analysis ought to be thrown out of the club because there is no way in the world we are after Arco. We are up to our armpits in the Unocal deal, and what I see over at Arco is that they decided that they were going to realize some values for their stockholders, and they darned well did it, too.

They put $3 billion in value into their stockholders in a matter of 10 days, and that is not insignificant.

Senator BIDEN. Having said that, assuming that another Boone Pickens were out there wanting to take over Arco, would it be more difficult or less difficult to do it now?

Mr. PICKENS. Oh, the best defense anytime against a takeover is to get your stock price up; that is it. I mean, the defense manual should have one page in it. Get the price up and you will not be vulnerable is what the page has on it.

Here, you have got a management that is trying to get the price of their stock up and, to me, that is the most healthy thing you can do for the owners, the stockholders of the company, is to get the price of the stock up.

Now, you know, I hate it because any refinery is going to be closed or any other operation is going to be shut down. If you look

at my record on personnel and building companies and everything. I have never torn down anything in my life. That is not my style.

At the same time, I am a realist and know that if you have an operation that is not making money, eventually something will have to be done about it. I also am realistic enough to know that sometimes some managers cannot make money off of different assets that other managers can make money off of.

So, you know, I am hopeful that the Arco refinery can be sold to somebody and it can operate just as it has, or even better than it has been operated in the past. But I am supposing that if you will get in and look at the numbers at Arco, you will find that they have done a tremendous study on what these assets—not only the refinery, but other assets—are turning out for the stockholders and they have decided to make some radical changes.

Senator BIDEN. Let me ask you one more question, Mr. Pickens, and I appreciate your time. Change worries everybody; those who have got the most worry most about change. When things are running smoothly and you are doing well, you like to just keep them that way.

You have have been given credit for, and I think, in fact, are responsible for introducing a change in the climate of corporate America, and the oil industry particular, that is significant; without saying it is good, bad or indifferent, it is a change.

People fear change and it is understandable that individuals, whether they are corporate presidents or public officials, tend to think of their own longevity in the job as one of the considerations in making their various judgments. So it does not surprise me that the gentleman you referred to—it disappoints me, but it does not surprise me that he does not want to shake your hand. You probably scare the hell out of him, and people are always frightened of change.

But one of the aspects of change that I would like you to at least end this portion with is what kind of impact does this restructuring that is taking place in the oil industry that you are playing a part in—what kind of change will this have for the American energy industry and our ability to compete worldwide?

Obviously, I assume you will think it is positive, but can you explain for me, beyond getting the price stock up and stockholders having more money, which is a fine thing—it is a capitalistic system and it is an objective of the system.

Beyond that, what beneficial impact has flowed from the abiiity of the future of American energy resources and our ability to compete?

Mr. PICKENS. Well, I am a geologist by education and I have been in the oil business for 35 years. I started out as a geologist for a major oil company and I left by my—it was my decision, but it only lasted 4 years.

You know, I have been involved in drilling a lot of wells. I know I have drilled more dry holes than anybody in this room. I have probably found more oil or gas than anybody in this room, too.

You know, worldwide, there is no doubt we have an over supply of crude oil. We also know that the United States is a high-cost producer, and I can demonstrate that by one statistic. Of all the wells that have been drilled in the world today from the time the

first well was drilled, 80 percent of them have been drilled in the lower 48.

Senator BIDEN. Eighty percent?

Mr. PICKENS. Eighty percent of them have, and therein lies the problem for the——

Senator BIDEN. Worldwide?

Mr. PICKENS. Yes. Worldwide, 80 percent of the wells that have been drilled have been drilled in the lower 48. We are a high-cost producer, so I do not see any reason today to straightjacket an industry and tell them that you have got to go out and spend your stockholders' cash flow on drilling more wells to look for more oil and gas.

I think that it should be totally left up to those managements to look after their stockholders, but more than anything else to invest their money in good, sound, economically feasible drilling prospects, and that is exactly what we do at Mesa Petroleum.

I tell our division managers—and I have three divisions, Denver, Midland, and Houston—I will tell them, I will drill anything you recommend, anything. We have the money; we are ready to drill and if you recommend it, we will drill it. Now, it is that straightforward.

So our people in our divisions have total control of their destiny, of the finding cost; they are totally responsible for that. And we will go along with whatever they want to do as far as their drilling activity is concerned.

So, here, remember that the oil that is in the ground today has been there for over 100 million years, probably, and it is not going to spoil and it is not going to go anyplace. So if we do not drill it in 1985, we might drill it in 1988 or 1995.

But why do we want to press somebody to go out and drill something that is economically not feasible, because the system will eventually have to digest that and the consumer will have to pay for that inefficiency?

So, leave the industry alone to drill what they believe is economically feasible.

Senator BIDEN. Does the consumer pay for the inefficiency or does the consumer benefit from the over supply?

Mr. PICKENS. The consumer is benefiting from the over supply—there is no doubt about it—today, and it is very likely that the price will get weaker. That is why, today, you have 1,860 rigs running in the United States; on Monday of this week, you did. That is the Hughes rig count.

We had 4,531 rigs running in the third week of December 1981. We are running about 40 percent of what we did in 1981. Why? It is because we have the uncertainties of price and we have prospects that will only accommodate 1,860 rigs running that are economically feasible.

Now, why do we want to hurry and develop and use up the last of our oil and gas reserves in the United States when we have foreign countries pushing the reserves to us, and all we want?

Senator BIDEN. Well, one of the things is that a lot of us who know a great deal less about the oil industry than you and others who will testify this morning and some of my colleagues who come

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from the producing rather than the consuming States, look at analogies that maybe are not so analogous.

We look at the steel industry and we look at other industries and wonder if that investment by the oil industry—I am not so concerned that you drill wells now. I am concerned, though, that you go out and buy pantyhose factories or hula hoop companies.

Mr. PICKENS. I am not guilty of that; no pantyhose.

Senator BIDEN. No, I am not suggesting that. I am not suggesting that anyone is guilty. I am just telling you why——

Mr. PICKENS. That is where you have too much cash-flow when you have a limited investment opportunity. If you go back and look at the April 30, 1984, Fortune magazine, they pick out the seven worst mergers of the decade. And who is it that has four of them? The oil industry.

Senator BIDEN. Right.

Mr. PICKENS. You have got Mobil-Marcor, you have got Exxon-Reliance Electric, you have got Sohio-Kennecott, and you have got Arco-Anaconda. Four out of seven of the worst mergers of the decade—four of them are in one industry. What is that telling you? They have too much money and they do not have anyplace to spend it.

That is why I say share that with the owners of the company, the stockholders, and that is exactly what Arco is doing and that is what their announcement was. They are going to share that with their stockholders.

That is what Phillips did. The Phillips recapitalization plan was good for the stockholders. It put $3 billion in their pockets is what it did. Now, it was misunderstood and not appreciated by a lot of people. They talk about the debt that Phillips had.

Phillips can service that debt without any trouble. That is not going to be any strain for them.

Senator BIDEN. Last question: Do you need police protection in Delaware?

Mr. PICKENS. Do I need it in Delaware? Listen, Judge Burger is—you are talking about the refinery, I guess. I do not know.

Senator BIDEN. No. We are a State that has historically been viewed as being sympathetic to our laws, and the Court of Chancery has been viewed as somewhat sympathetic to the directors of corporations rather than the stockholders.

Mr. PICKENS. I would like to comment about that. My feeling about the Delaware chancery courts—we have not always had decisions that we wanted because we have been before your chancery judges many times.

But I can say one thing; they darned well understand the corporate law and the decisions they come up with, I think, are well founded. And we may not always agree, but I can tell you what—the Delaware courts are the place to be when you have a corporate problem. It sure is not in those Oklahoma courts. Thank you very much. [Laughter.]

Senator BIDEN. Well, I appreciate that. I will be parochial again and somewhat chauvinistic. We take great pride in the quality of the judges that we insist upon. I can take no credit; it is the Governors who make those judgments. But I am glad to hear you say that.

Mr. PICKENS. They make good selections.

Senator MCCONNELL. Mr. Pickens, I apologize to the other witnesses that we have dominated you so long, but Senator Hatch has one more question.

Senator HATCH. Let me just ask you one other question that is commonly a criticism of what you are doing, but which I would like to have your response to. As you know, Members of Congress who must periodically stand for reelection are frequently placed in the difficult position of having to balance their short-term election interests with the longer term needs of the country.

So this is a traditional conflict between the role of the elected official as a politician or as a statesman which we commonly confront. Now, some have suggested that your activities are placing business managers in a similar, sometimes untenable situation of having to be increasingly responsive to the very short-term demands of their shareholders at the expense of long-term development in R & D and investment policies.

Now, how would you respond to that criticism?

Senator BIDEN. We understand hostile takeovers.

Mr. PICKENS. OK. This is a great article that is in today's Wall Street Journal, and if I could just read you one paragraph out of it, its title is "Takeover Threats Do Not Crimp Long Term Planning," and it is by Gregg Jarrell and Kenneth Lehn. Jarrell is chief economist and Lehn is deputy chief economist for the Securities and Exchange Commission.

This is the paragraph I would like to read:

> However, this theory is based on very shaky empirical evidence. In fact, no advocates have provided supporting facts. They have relied instead on reasonableness of this argument and anecdotes. This neglect is quite surprising because the economic sophistication of the proponents and because the theory has many indirect empirical implications that can be tested with readily available data.

That the R&D is not suffering from this situation, nor is the short term and the long term.

It is a good article, and they have done so much work on it that for me to try to answer the questions with experts like this giving empirical data, I think would be a waste of your time.

Senator HATCH. Thank you.

Senator MCCONNELL. Thanks a lot, Mr. Pickens. I appreciate your sticking with us.

Mr. PICKENS. Thank you.

Senator MCCONNELL. Chairman Miller of the Federal Trade Commission.

## STATEMENT OF HON. JAMES C. MILLER III, CHAIRMAN, FEDERAL TRADE COMMISSION, WASHINGTON, DC

Mr. MILLER. Mr. Chairman and members of the committee, it is a pleasure to have this opportunity to participate in these hearings on corporate takeover activity and on S. 473, which would place a temporary moratorium on hostile corporate takeovers.

It seems that hardly a week goes by without the appearance of yet another story concerning an actual or rumored takeover attempt. So-called corporate raiders have become household names and a whole new vocabulary has been developed. Government offi-

cials, academicians and business executives are debating the propriety of corporate takeover tactics.

Inevitably, many are proposing that the solution, whatever the problem, is more stringent regulation. That is not my view. Partly as a result of our efforts and those of the Department of Justice to screen out potentially anticompetitive mergers, it is clear that takeover activity generates net benefits to our economy.

Any ban on takeover activity, even if temporary, would impose large costs on consumers in the form of higher prices due to foregone efficiency gains and on stockholders, who would not be able to realize the increases in share values that generally result from takeovers.

Thus, I oppose S. 473 and similar legislation. Indeed, if our goal is to protect consumers and stockholders, as I believe it should be, the correct solution may well be less regulation, not more.

The fact that most mergers are friendly is obscured by the current focus on colorful entrepreneurs and complex strategies. More importantly, mergers, both friendly and unfriendly, have an important economic role to play. They serve to shift assets to higher valued uses, allow firms to take advantage of economies of scale and distribution, and provide incentives for managerial efficiency.

Thus, a freely operating market in corporate assets and corporate control promotes economic efficiency and a higher standard of living for all Americans. Stockholders benefit from this, as has been demonstrated convincingly by numerous studies of companies that have been party to takeover attempts.

In the aggregate, shareholders of target firms, as well as bidders, gain from completed takeovers. This is true for both tender offers and mergers. By contrast, shareholders tend to lose when a takeover attempt is not concluded successfully.

There are, of course, exceptions to the general proposition that takeovers are socialiy beneficial. I am not here to submit that they all are beneficial. For example, some may be undertaken solely for the tax advantages. But the proper solution to this problem lies in changing the tax code and not in mandating new rules surrounding mergers and acquisitions.

There are also cases where accumulations of market power will be of concern to antitrust authorities. I am confident, however, that the procedures we have in place at the FTC and the Department of Justice are fully capable of catching these cases.

Mergers occupy a significant portion of our resources. Guided by an economic efficiency and a consumer welfare perspective, we look very closely at any merger that threatens to create a significant risk of collusion or to create market dominance.

In the last two decades, the corporate takeover process has become subject to increased regulations at both the Federal and State levels. Before we make any additional changes, it seems to me we should take stock of where we are and what it is that we are trying to accomplish.

The Williams Act, which was passed in 1968 as a result of concerns that stockholders did not have adequate time and information to evaluate tender offers, subjected bidders to extensive regulatory requirements.

It imposed a minimum tender offer period, currently 20 business days. It imposed public disclosure requirements to purchasers of more than 5 percent of a company. It set up a requirement that offerors purchase tendered shares on a prorata rather than on a first-come, first-served basis. And its antifraud provisions gave target management standing to sue for relief.

Passage of the Williams Act also spurred tender offer legislation at the State level. Prior to 1968, only Virginia regulated tender offers. Then, a decade later, 36 States had statutes similar to or more stringent than the Williams Act.

Now, while that act presumably has been successful in providing shareholders with more time to evaluate offers, it has also provided incumbent management with more time to mount a defense and to locate alternative bidders.

Predictably, this has raised initial bidders' costs and lowered their expected returns, since they now face a higher risk that their efforts will be unsuccessful. The extended period during which new bidders may come forward decreases the incentives to develop the information necessary to be the first bidder.

This, in turn, reduces the amount of resources devoted to searching out promising targets and ultimately reduces the number of offers. The result has been an increase in the cash tender offer premium necessary to complete a takeover from an estimated 32 percent before passage of the act to 53 percent after its passage. State laws regulating tender offers have increased premiums another 20 percent.

Basically, there are two reasons for the higher premiums. First, since it has become more likely that any takeover attempt will involve more than one bidder, the final price for successfully concluding takeovers is, on average, higher.

Second, since the costs, including the costs of failure, of mounting a takeover attempt are higher, fewer attempts are undertaken. Specifically, the less profitable takeovers are not pursued, thereby raising the average premium associated with completed takeovers.

Now, the beneficiaries of this regulatory scheme are the shareholders of target firms that are successfully acquired, since they receive a higher average price for their shares. These benefits do not, however, necessarily represent a net social gain, but rather may simply represent a reallocation from the bidder to the target of the gains from the merger.

On the other hand, shareholders of companies that might have been acquired but are not, either because a takeoever attempt is defeated or because it is never attempted, are losers. These costs clearly represent a net loss to society due to the fact that efficiency-enhancing mergers are not undertaken because the costs of doing so are artificially high.

What does all this suggest about the direction our policy toward corporate takeovers should be taking? In my view, proposals for new regulation, especially those designed to make takeovers more difficult, should be approached with great caution.

It is, I think, no coincidence that calls for such regulation are coming increasingly from the management of potential target companies. I am more sympathetic to proposals to regulate some defen-

sive tactics more closely because the evidence indicates that defeating a takeover attempt hurts the target stockholders.

It would appear, however, that the effect of stricter regulation of defensive tactics would simply be to offset some of the effects of the existing requirements on bidders. If that is the case, it would be preferable to reduce the regulation of bidders and solve the problem at its source.

Instead of adding new regulation to either side of the takeover battle, I believe we should be evaluating the accumulating evidence concerning the regulation that already exists.

That evidence indicates, first, that mergers and acquisitions benefit stockholders and are, in general, socially beneficial. Second, the existing regulatory structure raises the cost of acquisitions, thereby discouraging some mergers that would otherwise take place. This evidence is sufficient, in my view, to raise serious questions about the desirability of our current regulatory framework.

In the final analysis, it may be best to leave decisions concerning such tactics to the market. Stockholders can and have voted not to permit the use of some tactics—for example, greenmail. Whether such decisions ultimately are in the stockholders' interest will be decided, then, by the market and reflected in the stock price.

Now, let me say at this point, Mr. Chairman, it is important that I emphasize what I have not said in my testimony or I am not advocating. I am not advocating greater concentration of wealth in the commercial activity of the United States.

I am not advocating more mergers. I am not saying that all mergers are good. I am not saying hostile takeovers are to be preferred to friendly takeovers. I am not saying that all hostile takeovers are good, and I am not saying defensive tactics, such as greenmail, shark repellants, poison pills and golden parachutes, are necessarily good. I have not tried to glorify the personalities on either side of the issue.

Instead, what I have tried to do is to emphasize that a policy that is in the combined interest of all stockholders will enhance economic efficiency. This is the direction regulatory policy has moved in other areas, and I think it should be attempted here as well.

Mr. Chairman, that completes my statement and I will be happy to address any questions you or your colleagues might have.

Senator MCCONNELL. Thank you, Chairman Miller. In takeover situations, do increases in stock prices in acquiring companies necessarily reflect the anticipation of gains in monopoly power by those firms?

Mr. MILLER. A takeover attempt and driving up the stock prices could very well reflect the expectations of creation of monopoly power, and that is our job to make sure that such a merger would not create monopoly power.

Senator MCCONNELL. Senator Metzenbaum.

Senator METZENBAUM. Mr. Miller, at the end you had an exculpatory statement saying I am not saying all mergers are good. But when I read your statement, I was taken aback by such language: "Mergers, both friendly and unfriendly, have an important economic role to play. They serve to shift assets to higher valued uses, allow firms to take advantage of economies of scale and distribution, and provide incentives for managerial efficiency."

And then towards the conclusion, you say, "That evidence indicates mergers and acquisitions benefit stockholders and are, in general, socially beneficial." Now, coming from the head of the FTC, those are pretty strong statements about how they are good for the economy and good for shareholders.

As I was sitting here, I was thinking how the shareholders did so well when Exxon took over Reliance Electric; I think that is closed now. Sohio bought Kennecott Copper; that went belly up—a good company in my community until that occurred. Lykes took over Youngstown Steel; its doors are totally shut. U.S. Steel bought Marathon Oil, and I do not think it has been a good acquisition for them.

Mobil bought Montgomery Ward, and that has been a failure. I do not understand how the stockholders benefited, how the economy benefited. I could go on with 10 more examples, and the concern I have is for the head of the FTC to be indicating that bigger is better—efficiencies of scale.

I have been down that road. I came out of the corporate world where ITT bought up everything under the sun and now they are trying to sell it off, and they probably do not even know what they own. So this whole question of efficiencies of scale and allowing firms to take advantage of economies of scale and distribution, provide incentives for managerial efficiency—all I find that a lot of these things did is they made the corporate executives more salary, give themselves more options, provide themselves with better pensions.

But I never really have all these cases that you tell me about where companies which combine together have been so great for the American people or for the shareholders. I wonder if you would give me 10 companies that you can think of where the acquisition really helped the shareholders and it shot the stock up

I am having trouble figuring that out because I do not think that this "bigger is better" the administration advocates is really a great philosophy for our American economic system.

Mr. MILLER. Well, Senator. I am not familiar with the word that you used to describe my statements toward the last of what I was not representing.

Senator METZENBAUM. What word did I use?

Mr. MILLER. I forgot. It was so scholarly that it——

Senator METZENBAUM. Exculpatory?

Mr. MILLER. My goodness, that is one that I am not familiar with. But in any event, whatever the nature of my statement, I think I emphasized that I am not advocating here that big is good, and I do not think you would find that in any statement I have ever written.

I have said big is not necessarily bad, but I do not think I have ever said that big is good. Second, in some of the instances you describe, it might be good to consider what the alternatives would be.

If firms were not purchased or acquired, perhaps the firms would have gone belly up and exited the market and the resources in that industry would have been depleted at a much more rapid rate.

Third, let me say that the market sometimes makes mistakes; that is, people bet their money and things go wrong. I think it is important to consider that in the marketplace, the people who

have the greatest incentive to make the right decision—that is, those who are putting up their money—are the ones who will be making those decisions.

I think that is a far better system than having someone else make them. Finally, I will be more than happy to provide you with evidence on mergers and acquisitions, hostile and friendly, in which the result was to increase the value of stockholders' assets.

The academic studies that have been performed indicate that, indeed, the effect overall, on average, of mergers has been to raise the value of stockholders' wealth.

Senator METZENBAUM. Well, when you have a——

Mr. MILLER. Could I go back to a question asked by the Chairman? I want to do that because when I read this statement over just a few moments ago, I realized that at the very end there might be some ambiguity.

There are situations, certainly, in which raising the value to stockholders can simply reveal the creation of monopoly power, and that is not what I mean. We screen those mergers for the creation of monopoly power. We try not to let that happen. I think we are doing a very good job, the FTC and the Department of Justice, in making sure that that does not happen.

But in a merger or an acquisition that is not characterized by the creation of monopoly power, those that do raise the value to the stockholders are revealing. The market, then, is revealing that there are greater efficiencies from that reallocation of resources.

Senator METZENBAUM. Mr. Miller, you should have heard Mr. Pickens' testimony as well as my questions because we are now living in an economy where many companies are worth more broken up than they are as a single piece. The whole Storer Communications deal that is pending at the moment is where the acquiror wants to buy the company and sell off the TV and radio stations and get more for the separate parts than the value of the stock.

I think that Mr. Pickens when he made his raid upon Gulf indicated that the company would be better off broken up or spinning it off. So the real question is, these economies of efficiency and the fact that the administration is saying that, well, maybe it is better to put the two companies together and they can do a better job of it—there is a monopoly question that we have to be concerned about.

But I think that the shareholders are not really getting much chance to have their views known, except when there is an actual takeover attempt. Would the FTC be supportive of some effort to provide for further democratization of corporate leadership, corporate direction, so that the shareholders would have a chance to nominate directors and would have a better chance to participate in corporate meetings than they presently do?

Mr. MILLER. Well, let me say first I think you have put your finger on an important issue. If a company is worth more broken up than it is in the conglomerate phase, then that is evidence that it should be broken up; that it is more efficient to manage those entities separately; that there may be diseconomies of synergism and size.

In fact, from the colloquys we have had before, Senator, I find it funny to be on the side of being in favor of breaking up and you are on the side of keeping it together. In fact, we have——

Senator METZENBAUM. I am not on that side. I just want to——

Mr. MILLER. Right. In fact, what we find is a lot of the merger statistics are revealing that there are a lot of spinoffs from companies, a lot of deconcentration and divestitures taking place.

To answer your question about so-called democratization of the voting process, I think there is some problem with the so-called separation of ownership and control, or the perception of that. It is in some major part reflective of some of the well-intentioned Government laws and regulations in this area.

But the kinds of so-called economic democracy proposals that I have seen, I would not be in favor of. In fact, I would oppose them outright. While my fellow Commissioners would speak for themselves, I could speak with a fair degree of confidence that a majority of the members of the Federal Trade Commission would oppose those as well.

Senator METZENBAUM. I do not know about any particular bills, but let me ask you, would you favor implementing programs to see to it that a shareholder could get a list of the other shareholders in order that he or she might be able to nominate a director?

Mr. MILLER. That is an interesting possibility, and let me say I would surely not——

Senator METZENBAUM. That is the law, as a matter of fact.

Mr. MILLER. Pardon?

Senator METZENBAUM. It is the law. The law does give the individual the right to get it.

Mr. MILLER. Right.

Senator METZENBAUM. Some corporations just use their economic position to force a lawsuit and tangle the individual up. The fact is, how can you be opposed to that? What would be so terrible?

Mr. MILLER. Well, we know that economic interests of all kinds tend to use the law and the process of litigation to slow down decisionmaking and to oppose opponents at every turn. In fact, we have done a lot of work on that down at the Federal Trade Commission—so-called rent-seeking activity.

I think you and I would agree that that sort of sham dealing is not something that makes the economy work, but it slows it down.

Senator METZENBAUM. Now, you approved the Texaco-Getty merger, but conditioned it upon the divestiture of some Getty assets. Why was Texaco required to sell east coast assets to Power Test?

Mr. MILLER. Well, first of all, they were not required to sell it to Power Test. My recollection is we signed a consent with them in which they agreed to sell those assets to someone that the Commission then would approve, or approve of the sale.

The reason for demanding this as a condition of approval of the merger was that we thought there were certain horizontal assets there that posed a threat of monopoly power, but that the major thrust of the merger, which was vertical in nature, should go forward.

Senator METZENBAUM. You were concerned that there would be too much concentration at the retail level, were you not?

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Mr. MILLER. Well, again, our watch word is not concentration at the Commission. The watch word is whether there is a creation of monopoly power. That is the reason that we were concerned.

Senator METZENBAUM. Were you aware of the fact that Getty had been actually itself a vital competitive force on the east coast and was actually often selling gasoline to independent distributors for 1½ to 2 cents below the price offered by other majors, and that there are now reports that Power Test is selling to these same distributors 1½ to 2 cents above the majors' price? Are you aware of that fact?

Mr. MILLER. Well, at the time we did not know exactly what the pricing policies of Power Test would be. But at the time we made our decision, we had all the data and information available to us that we had asked for, plus a lot of other information and expertise that the Commission staff had and the Commissioners had. We have weighed that evidence very carefully.

Again, the reason for asking for a spinoff of certain assets was our concern that there may be creation of monopoly power. But in our view, the acquisition that was approved, subject to the consent, or pursuant to the consent, was not going to create monopoly power.

Senator METZENBAUM. But the fact is that one independent distributor says that Getty was the only source of low-cost fuel oil in the market. Here comes the FTC into the picture, gets this merger brought before it of Texaco and Getty. The bottom line is distributors and retailers pay more, consumers pay more.

Has the FTC adequately protected the public interest in that instance?

Mr. MILLER. Well, I do not necessarily accept the characterizations that you have made. I would argue vociferously that the decision we made at the time was the appropriate one.

It is conceivable that we decide not to oppose a merger or to oppose it only in certain forms, but to approve it in other forms, and we make a mistake. It turns out that it may have some problems.

On the other hand, we may also make a mistake of the other variety; that is, we block or take issue with a merger that, in fact, had it gone through, would have helped consumers and competition quite a bit.

Our role down at the FTC, as we see it, is to do the best job we can, analyzing the effects of these things and make the distinction, draw a distinction between those that we believe are benign or procompetitive, which we let go, and those that have a significant potential for being anticompetitive, which we seek to block.

We want to minimize the sum of those two kinds of costs. That is what our objective is, and I think that is what is really called for in enforcing the law.

Senator METZENBAUM. What oil company mergers have you blocked in recent years?

Mr. MILLER. Well, I took office in October 1981, and let me just give you a brief rundown. I will be glad to provide this information for the record, if you like.

In Mobil-Marathon, we opposed Mobil's proposed acquisition of Marathon. We sought a preliminary injunction in Federal court.

Gulf-Cities Service—we opposed that acquisition in Federal court. Cities Service was later acquired by Occidental Petroleum. They dropped the merger after our opposition.

Mobil-Superior, we allowed to go through; we found no problems with that. Texaco-Getty—as you indicated, we signed a consent in which they agreed to spin off certain very important assets pursuant to consent. In fact, as we said, you go through with the merger as you propose; we will seek injunctive relief in the courts. Only if you file this consent or agree to these conditions will we not oppose it.

In Chevron-Gulf, a similar thing happened; we signed a consent with them saying that if you try to go forward in the present form, we will oppose you.

Senator METZENBAUM. Well, in the Mobil-Marathon one, did not a private suit actually stop that?

Mr. MILLER. Well, what you frequently have, Senator Metzenbaum, in any sort of proceeding before an agency of an antitrust variety is that those who are interested in it not only encourage the antitrust law enforcers to take issue, but sometimes they take issue with it in the form of a private suit as well. So you had that going at the same time we were reviewing it.

So, you know, whether it was pursuant only to the opposition in the courts from the management of Marathon or whether it was because of the FTC opposition, I do not know. But, basically, Mobil caved.

Senator METZENBAUM. We often hear that mergers are desirable because they bring about more efficiency production of goods. In fact, that is part of your testimony. What did the Commission or its staff determine was Texaco's goal here, more profits through greater efficiencies or opportunity to buy cheaper oil reserves?

Mr. MILLER. Well, again, Mobil-Marathon is one that we opposed. Mobil's acquisition of Superior is one that we did not oppose. The law reads quite clearly that even if it is benign, we have to let it go through. Only if we find a significant risk of a tendency to significantly reduce competition or create a monopoly can we take issue with it.

If it is either benign or if it is even, on balance, procompetitive, then we do not take issue with it. It is only when we find it monopolistic that we take issue with it. So as a matter of law, the burden is on the Federal Trade Commission to show that it would harm competition and consumers, not the other way around.

Senator METZENBAUM. If Exxon tries to buy the oil reserves of four majors, that would be permissible under your test, would it not, because it would not harm competition? Would that be benign?

Mr. MILLER. Do you mean simply the crude oil reserves?

Senator METZENBAUM. That is right.

Mr. MILLER. Well, look, I am not going to engage in a hypothetical because it has not been brought before me and I do not want to be accused of prejudgment. Let the record show I do not know of any such proposal that has been floated around.

But I would say that we have articulated the principles in a statement released in June 1982. The Justice Department has articulated its principles, with which we generally agree, in June of 1982, and then again in June 1984.

Now, applying those principles to that market is what we would do, and it is a fact that the production of crude oil—I am talking about that tier of what is usually a vertically integrated production process, but that tier is very deconcentrated. It is owned by a lot of people and nobody has a very significant share.

So, I mean it is conceivable that some additional horizontal increase in concentration at that level would pass antitrust scrutiny at the Federal Trade Commission, at the Justice Department, and in the Federal courts. But I do not want to be——

Senator METZENBAUM. So that we might find a situation where there would be great concentration of oil reserves.

Mr. MILLER. I did not say that.

Senator METZENBAUM. Well, that is what you are saying.

Mr. MILLER. No, I did not say that. I said that market is very, very unconcentrated right now. I would be glad to supply for the record a description of the structure and characteristics of that market. It is conceivable that there could be acquisitions in that market by large firms, firms that are readily identified especially at the retail level as being large, without violating or increasing the potential for anticompetitive effect.

I am not advocating that. I am not suggesting that such a proposal is on its way. I am not saying that, should I receive such a proposal, I would necessarily approve it, but it is potential.

I have tried to engage in a hypothetical with you and I hope you understand that I am not trying to be evasive, but as a law enforcement official I think it would be wrong to get pinned down too much on something.

Senator METZENBAUM. You are an advocate, I assume, of competition?

Mr. MILLER. Absolutely.

Senator METZENBAUM. I would assume you would welcome assistance in antitrust enforcement wherever you could get it. Therefore, I assume that you would welcome support and assistance from the State attorneys general.

Yet, the FTC recently voted to withhold Hart-Scott-Rodino merger information from State attorneys general based upon your legal reading of the FTC Act. Am I correct so far?

Mr. MILLER. I am a little reluctant to accept your earlier statement and characterization without taking issue with it, but in the interests of time, I will just agree, yes.

Senator METZENBAUM. Well, all right. Then, since you would welcome competition, since you could not work with the attorneys general because of your legal reading of the legal restraints of the FTC Act, would you support legislation that would permit you to cooperate with State attorneys general in merger enforcement?

Mr. MILLER. Well, let me say first, it is not only our interpretation of the Hart-Scott-Rodino Act—not the FTC Act, but the Hart-Scott-Rodino Act.

Senator METZENBAUM. Yes.

Mr. MILLER. That judgment has been upheld by the court of appeals.

Senator METZENBAUM. I am not challenging it.

Mr. MILLER. That is right. So that judgment, at least from what we know, was a correct one.

Now, the second is, as a policy matter, would it be a good idea to do it? I would say no.

Senator METZENBAUM. You do not want their cooperation?

Mr. MILLER. No—well, I do not want—the Federal Trade Commission Act, as you know—section 5 has an unfair methods-of-competition provision in it, and I am very reluctant to have them try to enforce the Federal Trade Commission Act as they have proposed, or even the Sherman Antitrust Act and the Clayton Act in this genre.

You see, we have a very significant responsibility to those firms that make a lot of information available to us, and the less control we have over that information, the more likely that that information will be abused and used for other purposes.

Anyone who believes that simply spreading that kind of hot data around will not result in its getting out has not been in Washington very long.

Senator METZENBAUM. The chairman says we have to move along, but I am disappointed in your answer because I think that anytime you can get cooperation from another law enforcement agency, the Federal Government ought to cooperate in that, I think, particularly when it is the State attorneys general.

Senator MCCONNELL. Thank you. Thank you, Chairman Miller.

We are going to try to run through the balance of these as quickly as we can. I would like to call on Mr. Rule, Acting Assistant Attorney General of the Antitrust Division.

Mr. MILLER. Thank you, Mr. Chairman.

Senator MCCONNELL. Thank you, Mr. Miller.

Mr. Rule, we will put your entire statement in the record and hope you can summarize it briefly.

**STATEMENT OF CHARLES F. RULE, ACTING ASSISTANT ATTORNEY GENERAL, ANTITRUST DIVISION, U.S. DEPARTMENT OF JUSTICE, WASHINGTON, DC**

Mr. RULE. Thank you, Mr. Chairman. I appreciate your request that I summarize the statement. As you may know, it is rather lengthy and I think if I could just hit the highlights this afternoon, I will be ready to answer any questions if there are any.

I am here, obviously, to discuss S. 473, which would provide a partial moratorium for oil mergers, but more generally, I am here to discuss corporate takeovers. I think the best way to discuss this is to start with corporate takeovers in general, and to start where our expertise is, just like that of the FTC, and that is in the area of antitrust law enforcement.

The current focus of the antitrust laws, as this committee knows, is in preventing mergers that harm consumer welfare. That is the appropriate focus of the antitrust laws and it is the only focus of the antitrust laws.

If a merger does not present a threat of harm to consumers, it is a normal market transaction and, as such, should be presumed beneficial. In effect, this is not to say that all mergers will be beneficial or that all mergers will increase economic efficiency. It is merely an understanding and a recognition that the market and the individuals who have to put up their money are more likely to

be able to determine, and should be allowed to bet their money on, the benefits to be achieved without being second-guessed by Government lawyers and bureaucrats who do not have as much riding on the decision and who probably are prone to make more mistakes than will the market. Moreover, the market also tends to correct itself.

The antitrust laws do not, and should not, distinguish between friendly and hostile takeovers. The competitive threat from a merger, whether or not it exists, does not depend on the amicability of the parties to a particular deal.

Having said that the antitrust laws, I think, provide the appropriate focus for judging the economic impacts of a merger—the competitive impacts—let me turn briefly to the question of whether or not corporate takeovers should be regulated in general for other reasons.

I frankly do not believe that the case has yet been made. In large part, the argument for regulation of corporate takeovers is based on five common criticisms, which I think upon close inspection, and as perhaps one of your next witnesses, Professor Jensen, will point out, are really without factual or theoretical support.

The first one that is often discussed is the danger that the current merger wave presents increasing economywide concentration. The fact of the matter is that even if one were to be concerned about such economywide concentration, or increases in it, the fact is that over the last decade or so concentration, economywide, has generally been maintained at about a constant level.

A great deal of the merger activity, and a great deal of the acquisition activity we are seeing, ultimately results in a great deal of divestitures and spinoffs and acquisitions by smaller companies of parts of larger companies. In effect, to some extent there has been a trend away from concentration, as has been noted here, particularly a move away from some of the conglomerate mergers in conglomerate form that characterized an earlier period, particularly the late 1960's.

The second criticism that one frequently hears is that corporate raiders cause economic havoc by busting up their targets. Again, there is no real support for the argument that divestitures are more likely when you are talking about a hostile, as opposed to a friendly, takeover.

Moreover, divestitures generally represent an attempt to adjust to changing market conditions. I think Senator Metzenbaum's recognition of the benefits that can occur when one spins off uncomplementary assets is very pertinent in this area and it is something that does not represent harm to the economy, but frequently can be a benefit.

The third criticism one hears is that the threat of takeovers leads corporations to focus on short-term returns rather than long-term investments. Once again, this is simply untrue.

I note that earlier someone read from an article by Gregg Jarrell and associates. That study indicates that, indeed, firms that concentrate on long-term earnings are not more likely to be subject to takeovers. Moreover, the fact that there are a number of stocks being traded in the market with high price earning ratios belies the fact that earnings are everything in terms of a stock's value.

Looking at IBM, for example, one can see a firm that has done rather well in the capital markets by investing a great deal in R&D.

The fourth criticism one frequently hears is that takeovers result in a loss of investment capital that could be used for more productive investments. First of all, I think it is important to note that takeovers generally represent productive investments. In essence, the acquiring firm is betting its money that it can take those assets and make them more productive, give them a higher value either by combining them with other assets, by replacing management, or something—in effect, making those assets more productive than they would be if they were retained in the hands of target management.

Second, it is important to realize that takeovers do not result in investment capital being somehow lost from the system. Generally, it is money that goes to shareholders, who then turn around and reinvest that money.

The fifth criticism that one hears is that mergers have led to unhealthy debt-equity ratios. Again, I do not think there is evidence on this point. I think one of the important points also to note is that Japanese companies, on average, tend to have higher debt-equity ratios, and I do not hear anybody crying about the ability of Japanese companies to compete in American markets.

While these five dangers appear to be innocuous by and large unsupported by the facts, I think we have less reason to be sanguine about abusive defensive tactics, such as poison pills. They may entrench incumbent management and decrease the value of firms.

However, I do not believe the case has yet been made that the market and State law, currently the predominant law in this area, are incapable of remedying the problem. Having said that, I do not believe that the benefits of Federal regulation are likely to be terribly substantial.

I think it is important to point out that the costs could be enormous. The normal compliance and administrative costs of any effort at Federal intervention, I think, are there and, at a minimum, those are the costs that would be incurred.

In addition, it is likely that such regulation would impair the efficiency of capital markets, impair the ability to shift assets from lower-valued uses to more highly valued uses, and the ability of the capital markets to discipline lazy, inefficient or incompetent managements.

By raising the costs and limiting the flexibility of takeovers, such regulation could diminish the incentives for firms—and, yes, corporate raiders—to search out firms whose value can be increased by a takeover.

By reducing the returns to research, the number of takeovers will decrease, as Chairman Miller has pointed out. Shareholders will be the losers because they will lose out on opportunities they otherwise would have had to realize a profit over and above what they would without the takeover. Consumers will also lose, as efficiencies that are created and fostered by an efficient capital market are lost.

Let me now turn very, very briefly to S. 473. As my statement indicates, we oppose that bill. As we have testified last year, we do

not believe that the current series of acquisitions and threatened acquisitions in the oil industry represent an economic threat.

While the FTC has done all the investigations recently of those mergers in that industry, our knowledge of the industry and our looking from the outside in confirm that they have pursued the correct course.

For the same reasons that I have outlined earlier as to the benefits of takeovers across the economy and the problems with Federal regulation to block, stop, or impede those takeovers, I think the committee should be very careful in interfering with the takeover process in this particular industry.

Obviously, oil is a very important industry. It plays a very important role throughout the economy, and it is important that it is operated at its maximum efficiency and that management operates in the best interests of its shareholders. They should not be shielded from the discipline of the market.

I also would note for the record that there is a very good article in today's Washington Post, a source I do not normally cite, by Robert Samuelson in the Business Section, that points out the benefits that have accrued to the oil industry as a result of this series of takeovers. I think it is well worth reading.

Finally, if elaborate studies are necessary—and I seriously doubt that they are, but if they are necessary—I do not believe that the Congress needs to impose a moratorium to perform them. There is adequate information always coming in. Those studies can be done without a moratorium and I would encourage the Congress, if that is felt necessary, to go ahead and do the studies, but certainly do not impose a moratorium that may have tremendous costs that we only discover after those studies are completed.

That concludes my summary of my remarks. I will be happy to answer any questions that the committee might have.

Senator MCCONNELL. Thank you, Mr. Rule. Since the hour is late, we are going to submit to you in writing questions which we would like you to respond to and include in the record.

Mr. RULE. OK.

Senator MCCONNELL. Thank you very much.

[The prepared statement follows:]

STATEMENT

OF

CHARLES F. RULE
ACTING ASSISTANT ATTORNEY GENERAL
ANTITRUST DIVISION

BEFORE THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

CONCERNING

S. 473 AND

CORPORATE TAKEOVERS

ON

MAY 1, 1985

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Mr. Chairman and members of the Committee:

I am pleased to be here this morning to provide the views of the Department of Justice concerning corporate takeovers. As requested, I will also discuss S. 473, a bill to temporarily prohibit hostile corporate takeovers of domestic petroleum companies. That bill raises important public issues that have ramifications not only for the oil companies currently in the headlines but for every sector of the American economy. We appreciate the opportunity to participate in the debate and hope that our comments will address the concerns that members of the Committee may have about current takeover activity.

I would like to begin by discussing the Department of Justice's specific role in policing corporate mergers and acquisitions. As this Committee is aware, we are charged under the Sherman and Clayton Acts with a duty to prevent acquisitions and mergers whose effects may be substantially to reduce competition. Enforcement of those acts by the Department, along with the Federal Trade Commission, is designed to protect American consumers from mergers that make the exercise of market power more likely. If, on balance, a particular merger or acquisition does not harm consumer welfare, then, at least from an economic perspective, it should be not be condemned on antitrust grounds. As currently enforced, the Department believes the antitrust laws are

adequate to proscribe anticompetitive mergers and acquisitions. So long as a merger does not unduly increase market power, then it is not appropriate on economic grounds for federal bureaucrats to second-guess the market and prevent a merger. Although a merger may not create the economic benefits expected by the parties, it is the parties who are willing to bet their money, in effect, that the merger will increase the value of the assets, and they are in a much better position than government lawyers to evaluate the potential economic benefits from a merger.

As a means of acquiring assets, hostile takeovers are no different from any other means of acquiring assets in their impact on concentration and other indicia of competition. The antitrust laws draw no distinction between so-called "friendly" and "hostile" takeovers, nor do we believe that any such distinction should be drawn. Rather, Section 7 of the Clayton Act, the statute most often applied to mergers and acquisitions, prohibits only those transactions that threaten to lessen significantly competition in any line of commerce in any section of the country. Proper evaluation of a merger's likely competitive effects requires analysis of possible increases in concentration in appropriately defined product and geographic markets, as well as consideration of the other factors set forth in the Department's Merger Guidelines. It is immaterial for purposes of competition policy whether both

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firms desire to merge or whether one firm is attempting an unfriendly takeover of another.

Furthermore, our antitrust enforcement mandate does not, and should not, authorize interference with mergers and acquisitions in order to protect private vested interests--be those the interests of the acquired firm's management, the acquirer, or of anyone else. The antitrust laws are based on our nation's fundamental belief that the discipline of free and open competition in the marketplace ensures the best allocation of resources and that this discipline best satisfies consumer desires. The Department firmly believes that these principles should continue to control both application of the antitrust laws and any other regulation of corporate merger activity.

Having mentioned the specific role of the Department in the merger and acquisition process, I would like now to turn to the broader issue of the need for regulation of the market for corporate control. 1/ Our basic precept is that competition in

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1/ Many of the points made here have been previously made by representatives of the Department of Justice and other Executive Branch agencies. See, e.g., Statement of former Assistant Attorney General William F. Baxter before the SEC Advisory Committee on Tender Offers (June 2, 1983); Comments of the U.S. Department of Justice, In The Matter of Corporate Takeover Regulation, SEC File No. 265-15 (May 2, 1983) ("Takeover Comments"); Testimony of Joseph R. Wright, Jr., Deputy Director, Office of Management and Budget, Before the Subcommittee on Securities of the Senate Committee on Banking, Housing, and Urban Affairs (April 4, 1985).

the market for corporate control, like competition in other sectors of the economy, yields net social benefits. For example, takeovers are an efficient means of ousting managements that are incompetent or are more interested in their own comfort than in enhancing their shareholders' wealth. Tender offers provide shareholders with the opportunity to sell their shares to new managements who wish to pursue different objectives or to pursue the same objectives in a more efficient manner than existing management. The tender offer mechanism may be the most efficient, and often the only effective, means of disciplining or replacing entrenched and inefficient management.

Moreover, takeovers help ensure the desirable movement of assets from lower- to higher-valued uses. The willingness to make a tender offer of sufficiently high value to induce shareholders to tender stock to the offeror generally reflects an expectation that the assets will be more efficiently deployed in the hands of the new owners than they were in the hands of the old ones. These efficiencies can flow from, among other things, the redeployment of the firm's assets and the combination of that firm's assets with the assets, including better management, of the acquiring firms. Even if some of the incentives for takeovers arise from purely financial considerations, such as expected tax benefits, that would not justify cumbersome regulation of takeovers. It is more

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appropriate to deal with such problems--if they are indeed problems--directly.

Despite the economic benefits of an active market for corporate control, increasingly we hear calls for regulation to eliminate abuses in the market. There are five common criticisms of corporate takeovers that, it is alleged, justify federal governmental intervention. These criticisms, however, are little more than "old wives' tales" and are belied by the facts.

First, it has been argued by some that takeovers increase concentration and should be halted for that reason alone. The Department of Justice sees no basis for this concern. As I indicated above, the Department and the Federal Trade Commission enforce the federal antitrust laws, and any increase in concentration of assets that is likely to reduce competition substantially in particular markets will be challenged under those laws.

As to the worry that takeovers are increasing the concentration of the economy's resources in fewer and fewer hands, we also do not believe that this concern warrants additional governmental intervention. First, the proponents of this argument never make clear the danger they believe flows from increases in economy-wide concentration. I have faith in

our democratic institutions, and I doubt that increased concentration really presents a threat to them. But even granting that we should be concerned about increases in economy-wide concentration, the current spate of takeovers has not increased concentration. 2/ Many takeovers result in the redeployment of assets from bigger to smaller firms or are accompanied by divestitures.

Second, it has been argued that the prospect of a takeover diverts management's attention from long-term to short-term performance. This argument lacks both theoretical foundation and factual support. If management and investors were concerned only with short-term profits, then we would seldom see stocks with high price-earnings ratios. However, current price-earnings ratios of 15 to 20 are commonly observed and reflect the market's expectation that earnings of the firms will be higher in the future than they are today. 3/ One need only look to IBM for an example of a firm that has been able to attract Wall Street while relying on long-term performance by maintaining a strong research and development budget.

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2/ Aggregate concentration has not increased during recent merger waves, or indeed anytime during the 1970s. See, for example, Lawrence J. White, "What Has Been Happening to Aggregate Concentration in the United States?," Journal of Industrial Economics 29(3)(March 1981) and Leonard Weiss, "The Extent and Effects of Aggregate Concentration," Journal of Law and Economics, Vol. XXXI (June 1983).

3/ See Economic Report of the President at 201-02 (Feb. 1985).

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Similarly, it is quite evident that many firms with no prospect of earning near-term profits are able to attract capital financing. This is because the stock market discounts the firm's expected future profits into a current price that accurately reflects expectations of the firm's true value.

This "myopic market" argument is also contradicted by a recent study conducted by the Office of the Chief Economist of the Securities and Exchange Commission. 4/ That study found that firms subject to takeovers spend less than half as much of their annual revenues on research and development as do firms in the same industry that are not takeover targets. It also found that the stock prices of companies that announce new research and development projects increase at the time of the announcement. These findings suggest that the market does not penalize long-term investments in research and development and that companies that underinvest in research and development may well have more to fear from takeovers than companies who structure sensible long-term investment programs.

Third, it has been argued that it is common for acquired firms to be "busted up" after a takeover at a large cost to

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4/ Institutional ownership, tender offer, and long-term investment, Securities and Exchange Commission, Office of Chief Economist, (April 1985).

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society. Two points are relevant here. 5/ First, there is no clear empirical evidence that corporate break-ups occur with greater frequency as a result of hostile takeovers. 6/ More important, even if corporate break-ups do follow more frequently from hostile takeovers, it is nevertheless likely that society benefits from such practices. The divestiture of a firm's assets by an acquirer generally indicates an effort to make the firm a more efficient, effective competitor. Much of the current merger activity represents divestitures that move assets away from the highly diversified conglomerate firms that grew in the late sixties and early seventies. This streamlining is quite likely to be in the best interests of the firm and society in general.

We recognize that some individuals, as well as some communities, may be harmed by specific divestitures or plant closings. However, many of these divestitures and closings could occur regardless of the takeover. Moreover, impeding the market for corporate control would be a particularly costly way to protect those interests. Because the impediment would retard innovation and perpetuate inefficiency, it is clear that our economy as a whole is not better off by continuing less

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5/ It should be recognized that this criticism is contrary to the concern that takeovers increase concentration.

6/ Jensen, "Takeovers; Folklore and Science," Harvard Business Review 114 (Nov.-Dec. 1984).

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efficient operations simply to protect those private interests. 7/

The last two common criticisms of takeovers concern the effects of financing the acquisition, and they apply to hostile takeovers as well as to friendly mergers. Critics of takeovers have argued that the large lines of credit used by the acquiring firms "crowd out" credit available for "productive" investments. Even ignoring the fact that these takeovers represent productive investments, the central assumption of the "crowding out" theory, that funds used to finance the transaction are somehow consumed and cannot be used for other purposes, is erroneous. In fact, the funds used by the acquiring firm are paid to the shareholders of the target firm, and those funds are generally returned to the capital markets as they are deposited in bank accounts or otherwise reinvested by these shareholders.

Lastly, critics have argued that the leveraging of firms to finance acquisitions elevates debt-equity ratios to

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7/ As Michael Jensen has stated, "[I]nnovations that increase standards of living in the long run initially produce changes that reduce the welfare of some individuals, at least in the short run. The development of efficient truck and air transport harmed the railroads and their workers; the rise of television hurt the radio industry. New and more efficient production, distribution or organization technology often imposes similar short-term costs." Id.

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unacceptable levels. The consequences of the increased use of leveraged takeovers and buyouts are issues that deserve a great deal of attention. Currently, however, there is no evidence that bankruptcies occur significantly more often as a direct result of firms increasing their leverage to finance acquisition programs. As a general matter, the Department has no reason to suspect that an increase in a firm's debt-equity ratio is contrary to the interests of its shareholders or to the long- or short-term prospects of the firm. Lacking evidence that a problem exists, we believe the market is capable of determining a firm's optimal debt-equity ratio.

While I believe these five alleged harms from takeovers are greatly exaggerated, one cannot be as definitive about the various defensive tactics employed by management to entrench itself and deprive shareholders of the benefits of a takeover. By impeding the market for corporate control, the vividly named tactics--such as "poison pills," "greenmail," and others--employed by management could conceivably be causing economic harm that warrants legal proscription. Similarly, the increased use of charter amendments, for example, to require supermajority approval of takeovers, may also be impeding economic efficiency. However, in the case of charter amendments, the increasing ability and willingness of institutions (such as pension funds) to organize effective opposition to such amendments where they threaten to harm the

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value of the corporation may significantly alleviate the danger. Although we do not yet have the data to ascertain the economic effects of these tactics and cannot say that current law is inadequate to control the abuses of defensive tactics, the Committee should keep three things in mind.

First and most important, examples of abusive defensive tactics would not by themselves justify the general regulation of takeovers. Some critics have argued that because takeovers lead to defensive tactics that decrease the value of corporations and so harm shareholders, the government should eliminate the incentive for defensive tactics by eliminating the threat to incumbent management from takeovers. This approach, in effect, is to throw the baby out with the bathwater. While it would indeed remove the incentive for defensive tactics, it would so by insulating inefficient and incompetent management from the discipline of the market for corporate control. Rather, the sensible solution (although I stress, we have not concluded that one is necessary) would be to prevent abusive defensive tactics and thereby to allow the market for corporate control to function with less interference.

Second, in evaluating defensive tactics, one must be very careful in analyzing their purpose and effect. Often a tactic that at first blush appears abusive may actually have

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benefits. For example, so called "golden parachutes", agreements that provide that management will obtain certain severance benefits if they are ousted as a result of a takeover, are often excoriated as efforts by management to steal from shareholders. However, on closer analysis, it appears that golden parachutes, if not excessive, may benefit shareholders. By reducing management's incentives to fight takeovers to preserve their jobs and encouraging management not to abandon the corporation as soon as a takeover appears likely, golden parachutes may in some cases facilitate efficient takeovers and preserve the value of corporations subject to takeovers.

Third, no showing has yet been made that state laws are inadequate to deal with the problem of abusive defensive tactics. The states, not the federal government, have traditionally governed the relationships between a corporation and its stockholders. Each of the states regulates defensive tactics by management through imposition of statutory or common law obligations to use reasonable business judgment in the conduct of corporate affairs. Under the "business judgment rule," courts will rarely second-guess the directors' conduct of corporate affairs, either in the takeover context or elsewhere, unless the directors can be shown to have engaged in

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self-dealing or fraudulent conduct. 8/ Once it is shown that management had an interest in the transaction, however, the business judgment rule shifts the burden to the directors to prove that the transaction was fair and in the best interests of the corporation. Courts are increasingly being called upon to consider how the business judgment rule applies in the takeover context.

From the preceding discussion, it should be apparent that the Department believes that the alleged harm from takeovers is greatly exaggerated. Thus, we cannot at this time say that there are any benefits from federal governmental intervention into the market for corporate control. However, the costs inherent in any such effort to regulate takeovers may be enormous--at a minimum, the administrative costs required of the implementing government agency and the compliance costs imposed on the affected firms are likely to be substantial. Even more significant are the short- and long-term effects such regulation would have on the efficiency of our economy. Takeovers do not generally represent arbitrary decisions. Rather, they generally reflect diligent efforts to search the market for firms with assets that would have a higher value if transferred to the control of new firms or managers. Because

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8/ See, e.g., Treadway Companies, Inc. v. Care Corp., 638 F.2d 357 (2d Cir. 1980); Norlin Corp. v. Rooney, Pace Inc., 744 F.2d 255 (2d Cir. 1984).

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this search and the efforts required to consummate the transfer of assets are not costless, these activities will not be undertaken unless the expected returns on the investment are sufficiently great to offset its costs. Regulations that adversely affect the long-term incentives that motivate these desirable activities will thus frustrate attempts to achieve the efficient transfer of assets to higher-valued uses.

More specifically, regulations or laws that increase the protection afforded incumbent management and make it more difficult for a potential acquirer to engage in a successful takeover decrease long-term incentives to search out and develop potential acquisitions. Information about potential bidders and targets is expensive to develop and, once the information is divulged to the market, it can freely be used by others. Regulations that unduly delay an acquirer's use of such information will tend to promote competing bids which, in turn, will make it less likely that the original offeror can profit from its discovery. Although in a short-term sense the bidding might result in a higher offer for a particular target's shareholders, in the long-term this "free-rider" effect will decrease the incentives to engage in search activities that lead to the movement of assets to more productive uses. If there are fewer incentives to search out candidates for takeovers, shareholders in general will have fewer opportunities to profit from takeovers. Moreover, by

impeding the desirable movement of assets, American consumers will be harmed.

In addition, regulation of mechanisms used to accomplish takeovers can cause shifts in corporate control to be accomplished through less-efficient mechanisms, such as through lengthy proxy battles, thereby impeding the efficient deployment of assets in our economy. Thus, extreme care must be taken to ensure that regulation does not harm either the short- or long-term functioning of the market for corporate control. 9/

The Department has specific concerns about the wisdom of further regulation of bidder tactics. 10/ For example, "front-end loaded" offers and "two-tier" offers generally are designed to overcome the current ability of target shareholders and competing bidders to "free ride" on the information generated by bidders. Because such tactics serve a socially beneficial purpose by enabling the developers of information to

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9/ I would like to emphasize that, while the current regulatory scheme for takeovers embodied in the Williams Act and other SEC and state law regulatory provisions impose substantial costs, the Department has not concluded that the costs of the present regulatory scheme outweigh the benefits of such regulation. We do believe, however, that those who advocate additional regulation bear the burden of establishing that it would be cost-effective.

10/ See, e.g., Economic Report of the President 203-06 (bidder tactics), 208-12 (Feb. 1985).

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appropriate the returns on their investments, attempts to restrict such tactics are likely to reduce the level of takeover activity. We are aware of no evidence of systematic abuse of individual shareholder rights resulting from such tactics. This apparent lack of abuse results from competition in the market for corporate control, existing securities regulation, and state-created appraisal rights. 11/ Moreover, empirical studies have shown that shareholders of both target and acquiring firms benefit from takeover activities. 12/

In sum, federal legislation imposing substantive limits on corporate takeovers would be a radical departure from reliance on state law remedies. Except for the disclosure requirements of current federal securities law, substantive restrictions on corporate management are best left to state, not federal, law. Leaving these matters to state law will maintain a division of state and federal authority over corporate affairs that has served both corporations and their shareholders well for more than half a century. It also allows for simultaneous use of a variety of different regulatory approaches to the same problem,

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11/ See Comments of the U.S. Department of Justice, In the Matter of Two-Tier Tender Offer Pricing and Non-Tender Offer Purchase Programs, SEC File No. S7-24-84 (September 14, 1984).

12/ For a survey of the literature, see Michael C. Jensen and Richard S. Ruback, "The Market for Corporate Control: The Scientific Evidence," Journal of Financial Economics (April 1983).

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with the determination of the best solution achievable through a comparison of the results. Thus, only if a serious market failure of national dimensions occurs should the federal government then consider taking appropriate steps to curb the potential for abuse.

I would like to turn now to S. 473, which is pending before the Committee. S. 473 would place a moratorium on the acquisition of control of a domestic petroleum company if the majority of the company's independent members of the board of directors disapproves of the acquisition. 13/ During this moratorium, which would be in effect from February 6, 1985, until six months following the date of the bill's enactment, various federal agencies would be required to investigate the effects of corporate takeovers on competition, corporate financing arrangements, credit markets, and energy exploration, development, producing, refining, transportation, distribution, and marketing. The results of those studies would then be submitted to Congress along with any recommendations for legislation.

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13/ The bill defines "control" to mean "the acquisition of more than 4 percent of the stock, share capital, or assets of a corporation." § 1(2). The term "independent" means that the director "is not an officer or employee of the corporation and has no substantial financial or commercial ties to the corporation other than the ownership of the corporation's stock." § 1(4)

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The Justice Department opposes S. 473 for several reasons. First, we do not believe such legislation is necessary. Mergers involving oil companies, while well publicized because of their overall size, appear to reflect the normal operation of the market and to result from changes in market conditions. 14/ As then Deputy Assistant Attorney General Douglas H. Ginsburg noted in congressional testimony last year, the Department had no basis upon which to conclude that merger activity in this industry was creating competitive problems, was adversely affecting the level of exploration for energy sources, or was otherwise adversely affecting the energy industry or its corporate stockholders. Mr. Ginsburg further stated that categorically barring mergers in particular industries or mergers over a certain size is fundamentally inconsistent with the basic premise of the antitrust laws that only unreasonable restraints on competition, determined on a case-by-case analysis, should be prohibited. 15/ A copy of that testimony has been supplied to the Committee for its convenience. We continue to adhere to the views stated in that testimony.

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14/ Economic Report of the President 194 (Feb. 1985).

15/ Hearings on S. 2362 Before the Subcomm. on Energy and Mineral Resources of the Senate Comm. on Energy and Natural Resources, 98th Cong., 2d Sess. 53 (April 10, 1984).

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Second, the bill would have harmful effects on our economy. It ignores the important role that mergers play in our economy, roles that I have discussed previously. Thus, by suspending all merger activity in the oil industry, the bill would prevent beneficial reallocation of assets and management, and thereby would decrease rather than increase consumer welfare.

Third, the bill makes the target firm's "independent" directors the sole arbiters of whether an acquisition can proceed, regardless of the desires of that firm's stockholders. Thus, the bill removes decision-making authority from the stockholders, the legal owners of the corporation. Such a requirement seeks primarily to insulate incumbent management from market forces and is therefore undesirable.

Fourth, the bill appears to be premised to some degree on the belief that current takeover attempts amount to abuses of our free enterprise system. More specifically, it has been alleged that such attempts are not being engineered by knowledgeable or capable persons, but by persons who would bust-up these "corporate citizens" without a second thought. As I have previously indicated, even if the primary motivation behind such takeover efforts is to divest the acquired assets, the Department believes that such activity will generally further the welfare of society. Indeed, even if the initial

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person lacks the knowledge and experience necessary to operate all of the acquisitions effectively, he certainly has every incentive to sell them off to the most capable managements.

Finally, even assuming arguendo that the extensive reports to Congress contemplated by S. 473 would provide a basis for useful legislation--a premise about which we have severe doubts--there is no valid reason to impose a moratorium on all oil company mergers in order to consider any findings and conclusions that may be reached. Congress and the interested agencies continually review emerging information as it is developed relating to these as well as a wide variety of issues, and their decisions are continually affected by new information. There simply is no basis to single out acquisitions in this industry for such drastic and potentially harmful treatment in the absence of compelling reasons to believe that there is, in fact, a serious problem that market mechanisms cannot address.

I would like to conclude by reiterating three points: First, the market for corporate control produces important economic and social benefits by facilitating the movement of corporate assets from lower- to higher-valued uses. This process is important to the promotion of productivity and innovation in our economy. Second, restraints on the market for corporate control should only be imposed if there are

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market failures and if the benefits that regulation offers society as a whole outweigh the costs it imposes. Because we believe that the capital markets are functioning efficiently, we do not believe that any further regulatory intrusions into the market are indicated. Finally, for the reasons I have expressed, the Department of Justice opposes enactment of S. 473.

Mr. Chairman, that concludes my prepared remarks. I would be happy to respond to any questions that you or other members of the Committee may have.

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Senator MCCONNELL. Our final two witnesses in a panel are Dr. Michael Jensen, of the Harvard Business School, and Dr. Dennis Mueller, of the University of Maryland.

Gentlemen, we will put your entire statements in the record and we hope that you can summarize them briefly. Mr. Jensen.

**STATEMENT OF A PANEL CONSISTING OF DR. MICHAEL C. JENSEN, LaCLARE PROFESSOR OF FINANCE AND BUSINESS ADMINISTRATION, UNIVERSITY OF ROCHESTER GRADUATE SCHOOL OF MANAGEMENT, ROCHESTER, NY, AND VISITING PROFESSOR OF BUSINESS ADMINISTRATION, HARVARD BUSINESS SCHOOL, CAMBRIDGE, MA; AND DENNIS MUELLER, DEPARTMENT OF ECONOMICS, UNIVERSITY OF MARYLAND, COLLEGE PARK, MD**

Dr. JENSEN. Thank you, Mr. Chairman. I will take this opportunity to make just a couple of very brief remarks since most of the detail is in my statement. Let me make clear that I believe that the scientific evidence on the effects of the activities that are taking place in the corporate control market (which include not only takeovers, but also divestitures, spinoffs, and liquidations) indicates that, on the average, those activities are benefitting both shareholders and consumers and the economy at large.

That is not to say that there are no mistakes being made. There are lots of dry holes drilled in the oil industry, and that is true in mergers and corporate control activity as well.

On the other hand, the evidence seems to be quite clear that, in the aggregate, those benefits vastly exceed the costs. And I do not think there is anything in the record that indicates additional regulation, and especially a moratorium, will generate benefits for the economy. In fact, it will generate substantial costs.

I would like to emphasize that remarks there is a great misinterpretation of what is going on in the oil industry. The changes that have occurred in the last dozen years in that industry have brought about a situation in which there is vast excess capacity and, surprisingly, excess reserves, and that it is economically efficient and desirable for that industry to shrink and for reserves to fall—not forever—and for refining and distribution facilities to be cut back to meet the reduced demand that has resulted from all the changes that have taken place.

It is the corporate control market that is forcing adjustments in this market that are desirable from the economy as a whole, although it certainly makes the life of being a CEO and a board member in this industry much more uncomfortable now than it used to be.

Let me say something about junk bonds. There is a great deal of criticism and controversy leveled at this new market. To avoid the emotion-laden terms, we will call them high-yield securities. These securities allow takeover specialists, as well as others, to finance activities in which they put up the assets of the target firm as collateral, and in which the lenders are willing to take more risks than are normally the case, say, in the triple A bond market.

There is nothing peculiar about that and there is nothing different about it from the normal state of affairs in business activities.

Sohio, for example, a number of years ago found itself in a situation of being a $1 billion company and having a substantial interest in the Prudhoe Bay oil field, with a necessity to raise substantial amounts of funds.

They were able to borrow over $5 billion in a very short period of time, a matter of 3 or 4 years, to develop that field and pay for their share of the costs of building a pipeline.

They did that, as entrepreneurs generally do when they borrow capital, by putting up claims on the assets that they were intending to develop—no different than what Boone Pickens has done in the Unocal offer. Those who would paint that picture as being different than that are simply mistaken.

Thank you very much.

Senator MCCONNELL. Thank you.

Dr. Mueller.

## STATEMENT OF DR. DENNIS MUELLER

Dr. MUELLER. The evidence I will briefly summarize here today is mostly taken from published articles and books and can be made available to the committee or for the record, if they wish.

What I would like to do today is to simply turn on a cautionary orange signal regarding the many efficiency advantages of mergers that have been claimed for them both by witnesses here today and in general in the discussion of this issue.

Evidence pertaining to the efficiency effects of mergers is available mainly from three types of studies: First, studies of the effects of mergers on the growth rates or market shares of the merging companies; second, studies of the effects of mergers on the profitability of the merging companies; and third, studies of the effects of mergers on the returns on common shares of the merging companies.

Now, it is worth emphasizing that the empirical support for the argument that mergers improve economic efficiency rest entirely on the third type of evidence; that is, evidence on shareholder returns.

Moreover, it is only the data on shareholder returns for the acquired companies that gives a consistent, positive picture of the effects of mergers. The large, premium-paid target shareholders do win their acquiescence in a takeover and do result in significant gains for these shareholders at the time of the takeovers.

All of the other evidence on efficiency effects of mergers indicates, however, that mergers either worsen efficiency or, at best, leave it unchanged. For example, if mergers improve the efficiency of the merging firms, this should translate into lower costs or more efficient investment. In either case, we should observe increases in market share for the merging firms or increases in their relative growth rates.

I recently completed a study of 209 acquisitions between 1950 and 1972 and I found, on average, a 70- to 80-percent loss in market share for the acquired companies over this period relative to similar companies that were not acquired. Similar results were found in a study of merging company growth rates before and after mergers.

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These were compared across seven countries. In five—Belgium, West Germany, France, Sweden, and the United Kingdom—there was no increase in the growth rates of merging firms relative to those of non-merging firms. In two, Holland and the United States, there was a significant decline in postmerger growth, implying a decline in efficiency.

A similar lack of support for the proposition that mergers improve efficiency is apparent in studies of the effects of mergers on profitability. I found, for example, in a study of 280 mergers that took place between 1962 and 1972 a slight decline in the pretax profitability of merging companies in the period following the mergers relative to both size and industry-matched nonmerging firms and relative to their base industries.

I do find, interestingly enough, in one comparison an improvement in aftertax profits for merging firms; that is, while beforetax profits fell slightly, suggesting a slight worsening of efficiency, the tax payments of merging firms fell by still more, resulting in an increase in aftertax profits for the merging firms.

Now, with respect to the issues facing this committee, I do not see reductions in payments to the IRS as so compelling a justification for mergers that one should encourage them, despite the fact that they do not increase real economic efficiency.

There has not been one study of mergers in the post-World War II period in the United States that has found postmerger profits of the merging firms to have increased over what one would have predicted in the absence of the mergers.

The final pieces of evidence concern shareholder returns. This literature is vast, involved, and somewhat contradictory. A careful examination of the evidence regarding acquiring companies, however, indicates that the shareholders who bought into these companies just before a merger was announced and held their shares for substantial periods thereafter—say, 2 to 5 years—tended to suffer losses in returns.

While these losses are often small in percentage terms, the much larger size of a typical acquiring firm relative to an acquired firm often makes the aggregate losses to acquiring firm shareholders over the long run greater than the gains to acquired company shareholders.

The combined evidence of efficiency effects of mergers based on acquiring and acquired company returns paints, at best, a mixed picture of mergers' efficiency effects.

I would urge the members of this committee to view with cautions the arguments that any mergers that do not substantially lessen competition should be presumed to increase efficiencies substantially, and thus should be applauded and encouraged.

I shall be happy to answer any questions committee members have.

The CHAIRMAN [presiding]. Professor Jensen, you have written an article in the Harvard Business Review, I believe, in which you described the effects of takeovers, mergers, and proxy fights on stock values.

Dr. JENSEN. Yes.

The CHAIRMAN. What are the sources of stock price increases in target and acquiring companies?

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Dr. JENSEN. Well, they come from many different sources. One cannot tell in any aggregate sense where that comes from without looking at the details of individual studies that have been done.

Let me explain in a case where I think we do know where the sources come from, and that is the oil industry, which represents a very large percentage of the total gains that are evidenced in recent times.

In the period after 1973, the oil industry witnessed a situation in which the price of crude oil increased by a factor of 10. Real interest rates rose and the quantity of oil consumed domestically fell. Expected future rates of growth of crude oil prices have declined, and the costs of exploration and development have increased substantially.

Now, all of those changes have been large and all of those changes imply—if we think about reserves as an inventory—all of those changes imply that the optimal level of inventories in this industry have fallen, and fallen substantially.

Furthermore, those changes imply that there is excess capacity not only in reserves, but also in refining and in distribution facilities. It means that there has to be a large adjustment in the structure of this industry.

There were various political forces and public opinion, pressuring the oil companies to maintain large investments in exploration and development activities. There is very good evidence in a recent study that on average, when industrial firms increase their investment expenditures, stock prices increase, and vice versa; they fall when investment expenditures are decreased.

The major exception to the results of that study is found in the oil industry over the period 1975 to 1981, in which the average response to announcements of increased exploration and development expenditures was substantial reductions in stock prices in those firms.

The major changes that had to come about in the oil industry—and as is true in many cases and as is true in minerals as well—were reductions in the size of the industry. This is why the data that Professor Mueller summarizes regarding decreases in growth rates or market shares in merging firms is irrelevant to the existence of benefits, mergers often to be in situations where efficiency requires a reduction in the scale of activities.

In fact, these merged firms in the oil industry have reduced their exploration and development expenditures. They have also cut back on marginal refineries and the distribution facilities.

The gains to buying and selling shareholders in three of these mergers that I looked at in detail—the DuPont-Conoco, the Gulf-Chevron, and the Texaco-Getty transactions—were over $17 billion.

In these cases, every single one of the acquiring firms' shareholders experienced substantial gains—over $1 billion, and sometimes over $2.5 billion. Now, my knowledge of what is going on in the mineral industries and the paper industry, indicates they are experiencing a similar set of phenomena.

There is excess capacity in the industry as a whole, while there are other parts of the industry where there are deficiencies in capacity. Thus, it makes no sense in such a situation to use valuable economic resources to build new capacity at a cost of a dollar on

the dollar in one part of the industry while there is excess capacity that can be purchased and used for 50 cents on the dollar in other parts of the industry.

The CHAIRMAN. Do those stock price increases reflect any factors that should be taken into account in antitrust analysis of a takeover?

Dr. JENSEN. When you look at these stock price gains, there always is the question whether they are coming from increased efficiency or perhaps from the acquisition of market power, monopoly power.

There have been now four or five very good studies done on that issue and the evidence in each of those studies indicates that the gains are not coming from the acquisition of monopoly power.

There does not seem to be any evidence that indicates that there should be antitrust concerns arising from takeover activity. That does not mean that there might not be some at some point and that one should stop looking, but from the evidence that we have been able to see, there is no reason to believe that those gains are coming out of the hides of consumers.

The CHAIRMAN. Now, I have two questions I would like to ask both of you. One is, in your view, does the threat or defense of a takeover attempt distract corporate managements from long-term planning in ways that reduce competition?

Dr. JENSEN. Well, I have heard that argument made a number of times and I do not believe there is a single piece of evidence that indicates this is true. The evidence I just quoted you about the response of the market to investment expenditures is consistent with the notion that, in fact, the market does value the efforts of managers who have an eye on the long term.

In fact, the notion of those capital values that are being reflected in stock prices is, by very definition, long term. They are not short term; they reflect the total value as of now of the total sequence of probability distributions of cash flows from that organization and the changes that are being generated into the future. Thus, these capitol values, stock prices are the appropriate things to maximize.

The accusations that managers are being forced to pay attention to the short term is, in fact, more likely a manifestation of the result that managers who have strategies that no longer fit the competitive environment are being pressured by the capital markets to change those strategies because, in fact, those strategies are not long-run maximizing.

Such managers find it easier to conclude that the market is wrong and they are right. But the evidence, I think, seems to indicate the opposite.

The CHAIRMAN. Professor Mueller?

Dr. MUELLER. Michael Jensen said he is not aware of any evidence that suggests——

The CHAIRMAN. Speak in your microphone. I can hardly hear you.

Dr. MUELLER. Michael Jensen said he is not aware of any evidence that suggests that the management is shifted toward short run orientation. I guess I could respond and say I am not aware of any evidence to suggest they are not shifted to short run orientation.

I do not think there have been any academic studies that really have looked at that question. I think one has to recognize, however, that there are several ways to avoid being taken over. I think the ways that have been emphasized here today from Boone Pickens through Michael Jensen say raise your stock price, manage the company well, and you will avoid being taken over.

Another way to avoid being taken over is to increase the size of your company because size is a protection. A good example, I guess, of the worry some people have about the pressures put on management to avoid takeover, independent of whether they are going to increase the stock price, is the example of the Beatrice-Esmark acquisition.

Beatrice is one of the companies that was featured in the Peters and Waterman book, "In Search of Excellence." It is one of the few exceptions of the best managed companies of a company that did engage in a lot of merger activity. Generally, the best managed companies have not done that.

Peters and Waterman emphasized, however, that Beatrice had a history of acquiring very small firms that fit in very well to their product mix. Last year or the year before—I forget—last year, I think it was, they undertook a $2.5 billion acquisition of Esmark, with—I have not studied it personally, but, again, this sort of Business Week-Wall Street Journal kind of report of this being that this would protect the Beatrice management from being taken over, or the Beatrice firm from being taken over. They are now too big to be taken over.

So there are many ways in which management can avoid being taken over. Raising the price of their shares is one, but just making yourself so big that you cannot be taken over is another, and I do not think those mergers necessarily improve efficiency. Indeed, I think they do not.

Dr. JENSEN. Could I make a comment? There is evidence that indicates that managers do take actions in the interests of the long term. The evidence I quoted on the responses to investment decisions is consistent with that notion.

Furthermore, there is evidence with respect to the responses of the market and management actions in shifting from Fifo accounting techniques to Lifo accounting techniques, which nominally reduce current income but increase cash flows and increase the value of the firm. In fact, the market sees through those reductions in income and generates an increase in value in response to that.

The evidence that was reported in this morning's Wall Street Journal by Ken Lehn and Gregg Jarrell, the chief economist at the SEC, on the relationships between R&D expenditures and merger activity is also consistent with the notion that the market perceives the longrun benefits and costs of management actions.

The CHAIRMAN. Now, I have the same question for each of you. To what extent, if any, is it in the interest of a company's shareholders to enable the company's management to resist takeover attempts?

Dr. JENSEN. Well, I think the evidence indicates, there are cases in which the activities by target management to resist takeover attempts benefit target firm shareholders. There is always a struggle when there are gains to be made from a takeover. There is a strug-

gle about how you divide the gains between the acquiring firm and the acquired firm. The evidence seems to indicate that a large fraction of the gains in voluntary mergers goes to the target shareholders. That is not true, contrary to what Professor Mueller said, in the case of hostile offers.

There, the evidence indicates the acquiring firms are able to retain significantly positive benefits. There is, however, a major concern with activities on the part of managers that go beyond negotiations to increase the price and actually cause the takeover attempt to fail; that is, shut off a bidder.

In the most dangerous recent manifestations of these kinds of things fall under the rubric of what are called poison pills. The poison pill concerns me, and I think it should be a concern of the courts, not because of the effects it has on the takeover issue in the short run, but because of what target firm managers are being allowed to do.

They are being allowed by issuance of a preferred stock or in some cases rights issues to not just issue securities, but to effect fundamental changes in the certificate of incorporation, the contract that governs the relationship between the shareholders and the board and the managers, and to do so without the vote of the shareholders.

What the provisions in these so-called poison pills amount to is a change in the voting rules and a change in the rules with respect to whether or not and under what conditions the shareholders will be able to sell their shares without the permission of the board of directors.

They, in effect, amount to a unilateral rewriting of the principal-agent contract that exists in the corporate charter, the principals being the shareholders and the agents being the board and the managers—a unilateral rewriting of that contract without permission of the principal.

The implications of this are astounding. These practices are enabling managers to set up rules of the game which effectively insulate themselves from any of the effective procedures that shareholders can take to protect themselves from the actions of managers when they are not in the shareholders' interests.

If allowed to continue—and so far the courts have not ruled unfavorably—I doubt that there will be much concern with hostile takeovers because there will not be any. The pills will effectively stop it, and they will do that at great cost to the economy and to the shareholders of those firms.

In the long run, there will be an adjustment. I do not think there should be regulation of it. I think we should let shareholders and the courts struggle with these issues, and I think they will get them worked out. But that is a major concern.

The CHAIRMAN. Professor Mueller?

Dr. MUELLER. I do not disagree——

The CHAIRMAN. Speak in your microphone.

Dr. MUELLER. I do not disagree much with Michael Jensen on this point. I think stockholders need a certain amount of time to evaluate a takeover bid, and to the extent that time is a management's friend of a management that is trying to resist a takeover,

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the stockholder and management interests sort of coincide for at least a period of time.

But I think after that length of time, then I would be opposed to additional legal strategies that allow management to resist a take-over bid that stockholders would like to accept.

The CHAIRMAN. I think that completes our questions. We want to express our appreciation to you and all the other witnesses who came today. We feel that you have made a contribution that is going to be very valuable to our committee record. Thank you very much.

We now stand adjourned.

[Whereupon, at 1:52 p.m., the committee was adjourned.]

[Prepared statement follows:]

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**Testimony before the Committee on the Judiciary**
**United States Senate**
**May 1, 1985**

MICHAEL C. JENSEN
La Clare Professor of Finance and Business Administration and
Director of the Managerial Economics Research Center,
Graduate School of Management, University of Rochester
and
Visiting Professor of Business Administration
Harvard Business School

I am an economist with special interests in Finance and Organization Theory. I am familiar with the scientific work on the market for corporate control through my research and writing in the area and that of my Phd students and colleagues, my activities as the Director of the Managerial Economics Research Center, and my role as Editor and Co-Editor of the Journal of Financial Economics (a leading scientific journal in the field) that has published much of the work in the area.

## Overview

I would like to spend my time today discussing:

1. A background view of the takeover market that provides an understanding of the conflicts and issues.

2. A summary of the scientific evidence on the effects of takeovers.

3. An explanation of the reasons for the takeovers and mergers in the petroleum industry and why these takeovers increase efficiency and thereby promote the national interest.

4. The effects of takeovers on the equity markets and the claims that managers are pressured to behave myopically.

5. The issues associated with anti-takeover measures and the disenfranchisement of shareholders.

6. The misunderstandings of the important role that "golden parachutes" play in reducing the conflicts of interests over takeovers and their consequent desireability as a means to help alleviate some of the costs and uncertainty facing managers.

## The Market for Corporate Control -- Background

### The benefits from takeovers

The market for corporate control that has arisen in the last two decades is generating large benefits for shareholders and for the economy as a whole. The corporate control market generates these gains by loosening the control over vast amounts of resources and making it possible for those resources to move more quickly to their highest-valued use. This occurs through:

-- Takeovers, both hostile and friendly
-- Divestitures
-- Spinoffs
-- Splitups
-- Leveraged buyouts
-- Going private transactions

We are seeing a normal healthy market in operation, both on the takeover side and on the divestiture side.

The total benefits have been huge as reflected in gains of $35 billion to stockholders of acquiring and acquired firms in approximately the 50 largest takeovers in the last 4 years (as estimated by the Office of the Chief Economist of the SEC).

### The market for corporate control and the managerial labor market

The market for corporate control is best viewed as a major component of the managerial labor market. It is the arena in which alternative management teams compete for the rights to manage corporate resources. Understanding this is crucial to understanding much of the rhetoric that takes place about the effects of hostile takeovers.

Managers formerly protected from competition for their jobs by antitrust constraints that prevented takeover of the nation's largest corporations are now facing a much more demanding environment and a more uncertain future. It is not surprising that many of them would like relief from this competition.

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## The market for corporate control as an agent for change

Some takeovers occur because incumbent managers are incompetent. Others occur because changing technology or market conditions mean a major restructuring of corporate assets is required and the internal processes for change in large corporations are too slow, costly and clumsy to accomplish the task efficiently.

It is often difficult for managers to abandon strategies they have spent years implementing, even when those strategies no longer contribute to survival of the organization. Such changes often require relocation and changes in managerial assignments and closure or sale of facilities or divisions. It is easier for new managers with no ties or history of associations with current managers or communities to make such changes. Moreover, it is common for the normal organizational resistance to change to fall significantly in the early stages of the reign of new top level managers. This coupled with a fresh view of the business can be a major advantage to new managers in formulating and implementing a new strategy after a takeover.

It is, of course, possible that the acquiring management team has incorrectly assessed the situation and is therefore less knowledgeable about the business and how to run it than the old managers. Such mistakes do occur and they will often lead to divestiture or spin off of the unit to get the organization under the hands of knowledgeable managers.

Mergers in the oil industry are a good example of the control market as an instrument of change.

As I explain in detail below, changing market conditions required a major restructuring of the petroleum industry, and virtually none of this was the fault of management. Management, however, must adjust to the changed conditions and recognize that many of its old practices and strategies are no longer viable.

In particular, some firms had to go out of business. This is much cheaper to accomplish through merger than by slow agonizing death in a competitive struggle in an industry with overcapacity. The end of such a processe often occurs in the bankruptcy courts with high losses and unnecessary destruction of valuable parts of the organization that could be used productively by others.

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**Takeovers are an important source of external control which protects investors when internal corporate controls break down.**

The takeover market provides investors with an important source of protection when the internal control mechanisms of the corporation, which operate through the board of directors, break down. When this happens, other management teams that recognize an opportunity to reorganize or redeploy the assets and thereby create new value can bid for the control rights in the takeover market. To be successful such bids must be at a premium over current market value. This provides investors an opportunity to realize part of the gains from reorganization and redeployment of the assets.

## Summary

In short, the external takeover market serves as a court of last resort that plays an important role in: 1) generating organizational change, never an easy task, 2) motivating the efficient utilization of resources and 3) protecting shareholders when the corporation's internal controls and board-level control mechanisms are slow, clumsy, or break down entirely.

# Analysis of Takeovers in the Petroleum Industry

## The effect of changes in the energy market in the last decade

Many changes have occurred in the energy market since 1973 that imply that large changes must occur in the basic structure of the petroleum industry. Virtually all of these changes in market conditions imply that the optimal level of reserves has fallen. These changes include:

-- a ten-fold increase in the price of crude oil
-- reduced annual consumption of crude oil in the U. S.
-- reduced expectations of future increases in the price of crude oil
-- increased exploration and development costs per barrel of new reserves
-- increased real interest rates

Each of these factors implies the optimal level of inventories (reserves) of oil fell over this period and that reductions in refining and distribution capacity must be made to bring these elements in line with

current market conditions. Reductions in the level of reserves is brought about by reducing the level of exploration and development activity. Substantial permanent reductions in exploration and development activity in turn means that some firms must leave the industry because holding reserves is an activity that is subject to substantial economies of scale while exploration and development is subject to diseconomies of scale.

Change is particularly difficult in rapidly changing environments that have been historically stable because it is difficult for organizations and management to change operating rules and practices that have existed for years and that have proven themselves adequate to deal with previous problems. Moreover, in this period oil companies generated large internal cash flows that enabled them to finance large expenditures without subjecting themselves to the discipline of the capital markets. The large profits also made them subject to strong public pressures to reinvest the cash flows in exploration and development to alleviate the popularly perceived problem that reserves were too low. Furthermore, while reserves in the industry were on average too high there were some firms that were substantially short of reserves and were spending to replenish them in order to avoid the organizational consequences associated with reserve difficiencies. The result was excessive exploration and development expenditures by the petroleum industry.

The notion thatoil industry exploration and development expenditures were too high is consistent with the finding that announcements of increases in exploration and development expenditures by oil companies in the period 1975-1981 were associated with systematic decreases in the announcing firm's stock price. Moreover, announcements of decreases in exploration and development expenditures were associated with increases in stock prices. This evidence is even more striking in view of the fact that increases in investment expenditures by industrial firms were associated with significant increases in stock prices and decreases in expenditures were associated with decreases in stock prices.[1]

The waste associated with exploration and development expenditures explains why it was possible to buy oil on Wall Street considerably cheaper than the cost of obtaining it by drilling holes in the ground. It wasn't that Wall Street was undervaluing the oil. It was valuing it correctly. But it was also correctly valuing the wasted expenditures on exploration and development. When these "taxes" on the oil were taken into account the net price of oil on Wall Street was very low.

[1]See John J. McConnell and Chris J. Muscarella, "Corporate Capital Expenditure Decisions and the Market Value of the Firm," Journal of Financial Economics, (forthcoming, 1985).

In this situation it was the capital markets, through the takeover market, that finally forced managers to respond to the economics of the new market conditions. Firms were led to purchase other firms and in the process to reduce excess expenditures on exploration and development and excess capacity in refining and distribution. The result has been large gains in efficiency. Total gains to the shareholders in the Gulf/Chevron, Getty/Texaco and Dupont/Conoco mergers, for example, has been over $17 billion.

## The Scientific Evidence on the Market for Corporate Control

There has been a vast amount of evidence and knowledge amassed by leading financial economists on the effects of the takeover market. A detailed summary of this evidence is available in my article, "Takeovers: Folklore and Science", Harvard Business Review (Nov.-Dec. 1984), and in Michael C. Jensen and Richard S. Ruback, "The Market for Corporate Control: The Scientific Evidence," Journal of Financial Economics, V.11 (April 1983). I briefly summarize here only the major conclusions of this evidence. The evidence indicates:

1. Takeovers benefit target shareholders -- premiums in hostile offers historically exceed 30% on average, and in recent times average roughly 50%.

2. Takeovers generate substantial gains -- historically 8.4% of the total value of both companies, and in recent times these gains seem to be even larger.

3. Evidence on antitakeover actions of managers such as targeted repurchases, poison pills and other restrictions on alienability of shares, fair price provisions and supermajority provisions is mixed. Some of these actions seem to harm shareholders and others do not.

4. Actions of managers that eliminate or prevent offers or mergers are most suspect as harmful to shareholders.

5. Golden parachutes for top level managers do not, on average, harm shareholders.

6. The activities of takeover specialists such as Icahn, Posner, Steinberg, and Pickens benefit shareholders.

7. Takeovers do not waste credit or resources, they generate gains.

8. Takeovers do not generate monopoly power.

## Current Concerns with the Effects of Takeovers

### Takeovers do not cause managers to behave myopically

It is argued by some that the fear of takeover causes managers to behave myopically and therefore to sacrifice long term benefits in order to increase short term profits.

I am confident this view is erroneous. There is much evidence that is inconsistent with it and no evidence that indicates it is true.

1. Even casual observation of the equity markets indicates the market does not value only current earnings. It values growth as well.

The mere fact that price/earnings ratios differ widely among securities indicates the market is valuing something other than current earnings. Indeed, the essence of a growth stock is one that has large investment projects that yield few short term cash flows but high future earnings and cash flows.

The continuing marketability of new issues for startup companies with little record of current earnings, the Genentechs of the world, is also inconsistent with the notion that the market does not value future earnings.

The evidence that (with the exception of the oil industry) stock prices respond positively to announcements of increased investment expenditures, and negatively to reduced expenditures, is also consistent with the notion that the equity market is not myopic.

2. The vast evidence on efficient markets which indicates that current stock prices appropriately incorporate all currently available public information is also inconsistent with the myopic markets hypothesis. Although the evidence is not literally 100% in support of the efficient market hypothesis, in my opinion there is no better documented proposition in any of the social sciences.

The evidence indicates, for example, that the market appropriately interprets the implications of corporate switches from straight line to

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accelerated depreciation techniques and from Fifo to Lifo inventory valuation techniques. Both of these accounting changes reduce reported current income and yet increase cash flows by reducing taxes. The evidence indicates the stock prices of firms that make such switches increase even though reported earnings decline. Moreover, the increases are on average about equal to estimates of the current market value of the stream of future tax savings.

Moreover, there is vast wealth to be earned by those who are smart enough to perceive instances where the market is undervaluing future earnings. All they need do is to buy up the companies and realize the significantly higher returns that will be forthcoming in the future. In fact this is exactly the strategy used by such successful investor/money managers as Warren Buffet who posted a phenomenal record of returns for many years. Buffet, however, left the business and dissolved his fund a number of years ago after concluding that there were not enough undervalued firms around to warrant continuation of his fund.

An alternative hypothesis

There is an alternative hypothesis that explains the current situation quite well.

Suppose that some managers are simply mistaken, i.e., their strategies are wrong, and that the stock market is telling them they are wrong. If they don't change, their stock prices will remain low. If the managers are indeed wrong, it is desireable for the stockholders and for the economy to remove them to make way for a change in strategy and more efficient utilization of the resources.

I might add that there will be cases in which the market does make mistakes, but it will not do so in a one sided way. That is, it will just as frequently overvalue a company as undervalue it.

Moreover, just as it is a manager's responsibility to convince consumers of the value of the products of his firm, it is also his responsibility to help convince investors of the value of his stock. In both dimensions promises must eventually be backed up with performance.

## Disenfranchisement of shareholders

There is concern that shareholders are being disenfranchised by:

a. antitakeover amendments

b. "poison pill" preferred stock and rights
c. dual classes of stock with differential voting rights

None of these is a problem for legislative or regulatory concern if it is accomplished by vote of the shareholders.

The poison pill issues are the only ones that generate serious concern at this time. These securities have the characteristic that they change certain fundamental aspects of the corporate rules of the game that govern the relationship between shareholders, managers and the board of directors. They do so on the occurrence of a control related event such as a takeover offer or the acquisition of a substantial block of stock or voting rights by an individual or a group.

The recent Delaware court decision upholding the poison pill rights issue of Household International will effectively stop all hostile takeovers of firms that adopt similar provisions. I provided expert testimony in this case and in the process studied the issues carefully. Unlike all other antitakeover devices, this one is so effective that it cannot be beaten by a prospective acquirer.

When the Household International Board of Directors issued this complicated right to their shareholders they changed the nature of the contractual relationship with their shareholders in a fundamental way. They effectively restricted the alienability of the common stock by prohibiting shareholders from selling their shares, without permission of the Board, into a control transaction at a price that involves a premium over market value of less than $6 billion. Since Household has a market value of less than $2 billion this is a premium of over 300% --more than 6 times higher than the average takeover premium of 50% common in recent times.

I have no doubt that this rights issue will harm shareholders. It will fundamentally impair the efficiency of any corporation that adopts it, and because of this it will reduce productivity in the economy.

I am a strong advocate of a broad interpretation of the business judgement rule, but I believe the court has erred in allowing the board to accomplish such a fundamental change in the structure of the organization without a vote of the shareholders. I do not believe the court would allow the board to unilaterally decide to make the organization a closed corporation by denying shareholders the right to sell their shares to anyone at a mutually agreeable price without the permission of the board. The Household International rights issue does just this with respect to the control related transactions that are so critically important to protecting shareholders when the normal internal board level control mechanisms

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break down. Two more cases of poison pills have also been heard by the courts with similar outcomes.

The problems with these special securities and the provisions they contain is not with their appropriateness but with the manner in which they are being implemented, that is, without vote of approval by the shareholders.

Managers and boards are the agents of shareholders, who are correctly viewed as the principals in these contracts that are effected through the corporate charter. The courts are effectively giving the agents the right to unilaterally change the critical control aspects of the contract, in particular the rights to fire the agent. The implications of this for economic activity, productivity and the health of the corporation are vast.

If the Delaware Supreme Court does not overturn this decision, the appropriate solution will be for shareholders to institute amendments to the corporate charter to restrict the board's power to take such actions. I see no reason for federal regulation.

**Divestitures are desireable**

If assets are to move to their most highly valued use, acquirers must be able to sell off assets to those who can use them more productively. Therefore, divestitures are a critical element in the functioning of the corporate control market and it is important to avoid inhibiting them.

Labelling divestitures with emotional terms such as "bustups" is not a substitute for analysis or evidence.

Moreover it is important to recognize that plants and assets that are divested do not dissappear, they are reallocated. Sometimes they continue to be used in similar ways and in other cases they are used in very different ways. But in all cases they are moving to uses that their new owners are betting are more productive. This is beneficial to society.

Finally it is useful to recognize that the takeover and divestiture market provides a powerful private market constraint against bigness for the sake of bigness. The potential gains available to those who correctly perceive that a firm can be purchased for less than the value realizeable from the sale of its components provide a strong incentive for entrepreneurs to search out such opportunities and to capitalize on them.

The possibility of such takeovers also serves to motivate managers to avoid putting together uneconomic conglomerates and to break up those that

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currently exist. This is now happening. I believe that careful study will show that the defensive reaction of many firms to avoid an unwanted takeover often leads to policy changes that are similar to the proposed actions of the potential acquirer. Examples of this are the sale of "crown jewels," and divestitures brought on by the desire to liquidate large debt positions incurred to buy back stock or to make other payments to stockholders. Unfortunately, the basic economic sense of these transactions is often lost in the blur of emotional rhetoric and controversy that surrounds these events. Congress must look through to the economic reality of the gains that are produced by these activities.

**The legitimate concerns of managers**

The interests of corporate managers is not the same as the interests of corporations as organizations.

There are always winners and losers when competition causes change, and this is especially true in that branch of the managerial labor market called the takeover market.

As the technology and skills of the participants in the takeover market become more sophisticated and as the restrictions on takeovers imposed by the antitrust laws have been relaxed, the costs of takeovers has fallen. This means that the largest of the Fortune 500 companies are now subject to takeover, a condition formerly limited to much smaller firms.

The abolition of mere size as a deterrent to takeover is clearly desireable because it has made possible the realization of truly large gains from reallocating larger collections of assets to more productive uses.

This new susceptibility to takeover has created a new contracting environment for top-level managers. Many of these managers are anxious -- and legitimately so -- and it will take a while for the system to work out an appropriate set of practices and contracts that will reflect the risks and rewards of the new environment.

It is unfortunate that a major part of the solution to the conflicts of interest between shareholders and managers has been vastly misunderstood. I am referring to severance contracts that compensate managers for the loss of their jobs in the event of a change in control -- what has been popularly labelled "golden parachutes."

These contracts are clearly desireable, even when judged solely from the viewpoint of the interests of shareholders, but they are also in the interest of society. When correctly implemented they help reduce the

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conflicts of interest between shareholders and management at times of takeover and therefore facilitate realization of the productive gains generated by changes in control.

At times of takeover shareholders are implicitly asking the top-level managers of their firm to negotiate a deal for them that also frequently involves the imposition of large personal costs on the managers and their families. These costs involve substantial moving costs, the loss of position, power, prestige, and even the loss of their jobs. Shareholders are asking the very people who are most likely to have invested considerable amounts of time and energy (in some cases even a life's work) into building a successful organization to negotiate its sale and the possible redirection of its resources.

It is important to face up to the existence of these conflicts and to structure the contracts with managers to reduce them. It makes no sense to hire a realtor to sell your house and then penalize him for doing so. Yet that is the implication of many of the emotional reactions to the existence of control related severance contracts. The restrictions and tax penalties imposed on these severance payments by the Deficit Reduction Act of 1984 are unwise interferences in the contracting freedoms of shareholders and managers. They should be eliminated. Moreover, it is important to eliminate the vast misunderstandings about the purpose and effects of these contracts that has been fostered by past rhetoric on the topic.

**Conclusion**

In conclusion, I want to emphasize that the evidence indicates takeovers generate large benefits to shareholders. Yet virtually all proposals to protect shareholders that I have seen will harm them by either eliminating or reducing the probability of successful hostile tender offers. These proposals will also inhibit the attainment of the productivity increases that I believe are the source of the gains.

This is particularly true of all the proposals to restrict or prohibit targeted repurchases (or what is pejoratively labelled "greenmail" in popular discussions).

Shareholders and management can with relative ease prohibit these transactions without legislation.

All managers have to do to prohibit them is to propose a charter amendment that (like Ulysses tieing himself to the mast) would prohibit the board or management from making such payments.

The ease and simplicity of this solution to the targeted repurchase problem, if there is a problem, makes clear that the difficulty lies with managers who want to use these repurchases to help protect themselves from competition in the market for corporate control.

What many managers seem to want is not the elimination of targeted repurchases but the partial or complete elimination of hostile takeovers, and this would be the effect of virtually every proposal I have seen to restrict "greenmail".

Thank you for providing me the opportunity to make these remarks.



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